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White Paper on the Personal Tax and Transfer Systems

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A. Taxation and our Choice of Society

Tax reform is always approached with a certain degree of trepidation. In the short term, the consequences of a tax system are certainly highly visible to the population as a whole, insofar as their immediate effects are concerned. The long term effects often go deeper but, because they make themselves felt only gradually, there is frequently a tendency to treat them less seriously. No tax is completely neutral in its effects on economic growth and income distribution. Maintaining an existing tax structure thus implies prolonging its consequences. Changing the tax structure therefore inevitably means altering the economic incentives operating within society, as well as the criteria for income distribution. A kind of economic and social "philosophy" underlies every tax reform. So it is of fundamental importance that the goals of the reform be made clear to ensure that there is an understanding of how it is applied, always a complicated matter in any country, but especially so in the kind of federal system we live in.

It can be argued that a government should content itself with applying a limited number of tax rates to tax bases which are as large as possible. For example, using income as the tax base, the same rate should be applied to every income bracket, allowing for family-related expenses. Some people have been suggesting for a number of years that the greater portion of government expenditures be financed by a single tax on consumption as a whole.

In practice, no government, except local or regional governments, has confined itself to a single tax field to which a few rates, much less one only, would apply. The considerable growth in public spending has increased government's financing requirements to such an extent that sources of tax revenues have inevitably multiplied.

B. Growth and Financing of Expenditures in Modern States

(a) Social programs

In the wake of the social calamity which the West experienced during the Great Depression, one cannot help observing that the crisis was all the more severe because the drop in employment caused a collapse in consumption, since workers had almost no financial protection after the loss of their jobs.

The vicious circle of a fall in employment leading to a drastic cut in consumption, which in turn caused a further drop in employment, left a lasting impact on a generation which certainly was to have a better grasp of social and economic interdependence than its predecessors: as a condition of economic prosperity for some, as a prerequisite to social justice for others.

Be that as it may, two works were published within six years of each other which, for two successive generations, would revolutionize the basic framework of social and economic policy: *The General Theory of Employment, Interest and Money*, by John Maynard Keynes, in 1936, and the Beveridge Report on social security (*Social Insurance and Allied Services*), in 1942.

The enormous influence of the first work is so well known that there is no need to point out that governments today are completely under its sway, often without realizing that what has taken place in mores is in total reaction to the economic policies followed before and that this upheaval would allow for the systematic implementation of the recommendations of the second work.

The influence of the report of the Royal Commission chaired by Lord Beveridge is less well known. For the first time in the countries of the Anglo-Saxon world, a "Magna Carta" of social security was systematically laid out. Based on equality of opportunity, on programs which would apply universally and on income redistribution objectives, this Magna Carta would be taken up throughout the Anglo-Saxon world and encounter the more diverse and, at the outset, less coordinated experiments which appeared throughout most of Europe.

In Canada, these new directions were to be found in the deliberations of the 1938 National Commission on employment, and the March Report of 1943. But about this time, policies were already being introduced which fit the same pattern, such as family allowances and unemployment insurance.

Subsequently, old age security, hospital insurance and health insurance were added while, at the same time, social aid was systematized. Universal access to education was expanded, while the age cutoff for compulsory school attendance was raised.

With the achievement of the most important reforms, the focus shifted over the past ten years to extending the programs, on the basis of specific needs of particular groups, rather than on universal programs. In this way, the guaranteed income supplement was introduced for senior citizens, while the employment income supplement was established in Québec.

Some programs which could very well have been made universal were restricted to certain groups. Thus prescription drugs were provided without charge for people on social assistance and, in Québec and a few other provinces, to senior citizens. Similarly, dental care expenses were never covered, although hospital and medical expenses were. In Québec, dental coverage was provided for children under 12; the other provinces did not choose to follow this lead.

The universalization of programs with no user fees resulted in such a marked growth in government expenditures and such an increase in tax burdens that, to meet all these new expenses, governments had to put aside any attempt to simplify the tax structure. Relying on the income tax alone to finance the growth in expenditures would have been so highly visible that the entire process would have been jeopardized. Even more serious, the most obvious increases in the tax burden would have fallen on low and middle-income earners, even assuming that all high incomes were subject to confiscation.

There followed a proliferation of taxes, some visible, others not; of course, some were applied to the personal income tax base, others to business income; some applied to personal and business capital, property taxes for instance, others to personal consumption and the value of business output. "Voluntary" taxes on spirits, tobacco and gambling grew in importance, all the greater because they were tied to social censure, whether real or imagined, and because they showed remarkably low price elasticity, so that maximum revenue was derived from these sources.

Indeed, the only constraint on the multiplication of tax bases was the imagination of the legislators.

(b) Direction and support for economic development

Meanwhile, the scope of public sector economic activity increased as governments took direct control over development.

Over the years, the system became more refined. More and more sophisticated methods were employed to direct industrial development. For a start, the case of steel mills at the time of the Korean War could be mentioned and, in the years that followed, oil and gas exploration, or certain priority activities (investments in manufacturing, exports and, finally, research and development). Financial institutions were favoured with a host of fiscal measures (tax abatements on certain bank reserves, elimination of the tax on mutual insurance companies). Finally, the distinctive tax treatment of small and medium-sized business firms as opposed to large corporations became a matter of increasing priority as it was realized that the growing importance of small business for the creation of employment had to be bolstered by tax measures.

In other areas, residential construction, agriculture and fisheries not only gave rise to efforts at tax discrimination, but to all kinds of direct assistance, usually in the form of subsidies.

Moreover, subsidies gradually became an accepted form of investment assistance, in areas of high unemployment to begin with, but as unemployment spread and increased, in whole provinces. Today, in fact, no investment in manufacturing takes place east of the Ottawa River to the Atlantic seaboard without some form of subsidy.

While these direction and support measures were being employed, an increasing number of government corporations were being set up.

Finally, these concerns with the direction of economic activity inevitably led governments to make a distinction between the taxation of income, capital, consumption and savings. An increasing emphasis was put on incentives to saving and investment as taxes on income, profits and capital became increasingly onerous. These incentives were maintained and even enhanced without, however, entirely eliminating the taxation of income generated by savings and investment.

A series of exemptions, tax credits and refunds of all kinds were then established to make saving more attractive: the special tax status of the capital gain on a principal residence and of the imputed income on the equity in that residence, tax credits on the dividends of Canadian corporations, the exemption of a limited amount of interest income, the tax status of registered retirement savings plans, registered home ownership savings plans, multiple unit residential buildings, the Québec Stock Savings Plan; all these plans were designed to encourage saving and certain kinds of investment considered socially or economically desirable. As the years went by, the formulas became more and more refined, coming ever closer to a kind of taxation surgery. For example, the tax shelters which provided for financing of films or research and development became, in relation to the tax laws as a whole, a painstaking operation whose precision was matched only by the complexity of the calculations they required.

(c) Unavoidable decisions

It was inevitable that sooner or later it would be difficult to make a decision between the growing costs of social programs which had become so widespread that even the most modest improvement would be extremely costly, and economic interventions whose costs, though lower, would be seen, especially in periods of economic recession, as a withdrawal from the sums earmarked for social security measures.

Various levels of government felt that the deadline for these painful choices could be postponed by transferring funds from one level of government to another. When one level was being squeezed by the pressures we have just described, it could obtain temporary relief in the form of transfers of funds from another level of government, allowing it to set aside, for a few years, the inexorable movement towards an increase in taxes.

The Canadian federal framework was well suited to this kind of shift. A few years after the Beveridge Report began to be applied in Canada, a system of equalization payments was instituted under which the federal government agreed to make transfers to the provinces which allowed them to provide services whose quality was, if not uniform from one province to another, then at least comparable. Moreover, the tax rates applicable to personal income, to corporate profits and to estates were, until 1972, viewed as something which could be divided between the federal and provincial governments. The division of taxation "points" became the preferred method of providing sources of taxation for the provinces which, under the Constitution, were responsible for health and education, the two sectors undergoing the greatest explosion in expenditures. Finally, specific transfers for health and post-secondary education were added to fill in the picture.

In Canada, contrary to most other federations, funds were distributed to the provinces with no strings attached as to how they could be applied. In addition, the provinces had complete control over transfers to local communities, since the latter come under provincial jurisdiction. It thus became possible for them to not only hide their deficits, by obtaining larger unconditional transfers from Ottawa, but also to reduce, should they wish to, their transfers to local communities and so reduce their apparent debt.

Given the — unique — framework of the system, the inevitable decisions could be delayed for several years.

One last operation hastened the destruction of this system of public finances: indexation. The rapid growth in inflation during the 1970s had a twofold effect. First, it was quickly agreed in Canada (in 1973) that it was neither normal nor fair to apply a progressive tax structure to incomes which were increasing in nominal terms, mainly because of the rise in prices, but not in real terms. It was therefore decided to index personal exemptions and the tax table to the rate of increase in the cost of living.

For the same reason, the acceleration in the rise of the cost of living index, it was decided to index most pensions: social aid benefits, family allowances, old age security pensions, not to mention other benefits, such as unemployment insurance, which were directly related to the nominal wage level. Similarly, indexing wages to the cost of living became the point of departure for collective bargaining in the public sector.

To sum up, it was found acceptable to use the indexation mechanism to reduce revenues and increase budgetary expenditures. The total deficit of the system as a whole was beginning to cause concern.

In the fall of 1981, the Canadian economy was hit by a deep recession which originated in the United States and subsequently spread to the rest of the world. During 1982, the recession caused a 5% drop in the **gross national product*** in Canada.

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* Terms in boldface type are defined in the glossary.

This was not only the poorest year of economic performance since the 1930s, but also the worst performance of any industrialized country. Tax revenues were down significantly from what had been predicted at the beginning of 1981. Expenditures reflected the effect of unusually high interest rates on debt-servicing costs and the inevitable increases in spending tied to special employment programs and the cost of social services. The deficits of most governments rose dramatically. The tax increases which had been postponed, delayed and eventually disguised could no longer be avoided by any level of government. Overnight, spending was cut and existing programs came under close scrutiny. In many countries the welfare state was called into question. The size of the deficits, frightening for the future, caused many governments to reexamine their policies.

Individuals examined their attitudes and aspirations. Was it really worthwhile to pay such high taxes for government services? Was it not true that some people abused the progams open to them? Who could deny that collective or community goals placed intolerable restrictions on the free use of the income that each person had earned through his own efforts? Already, thanks to the adoption of Proposition 13 in California in 1978, many of the dogmas and absolutes of the welfare state could be questioned without running the risk of being branded an iconoclast. Had not President Reagan's tax policy drastically altered the balance between collective aspirations and the individual's real needs?

C. Québec's experience

(a) The expanded role of government since 1960

The development of Québec over the recent past must be examined from this perspective. The conclusions that are drawn will form the basis of tax policy for the years to come.

Given the situation we have sketched, Québec has demonstrated a definite originality. The revolution in ideas and policies which was sweeping the world collided head on with a traditional form of social organization.

Nevertheless, Québec was poorly prepared for the upheaval in the structures of social security and economic organization. The lack of health and education facilities compared with the rest of North America was notorious. Most of the services of this kind were controlled by religious administrations which were hardly in a position to universalize benefits. Government intervention in the economy remained embryonic and a dogmatic resistance prevented any development in that regard. The question was even asked as to whether the study of Keynes' *General Theory* was compatible with religious observance.

All that was eventually swept away, but the cost of catching up during the Quiet Revolution was enormous. Particulary in education, the fact that the percentage of people attending secondary school and university was among the lowest for developed countries required a gigantic make-up effort, in terms of plant and personnel, which swelled budgets, and all the more so since the pace of the process was pushed to its maximum. The story was the same, though to a lesser degree, for health services.

— Social security and public services

The Quiet Revolution marked the end of resistance to a general framework of social security. In fact, once the major programs had been set up, Québec tended to take the lead among the provinces in improving and extending these programs. The pendulum had swung completely to the other side. The ease with which successive Québec governments were able to obtain transfers from the federal government during the greater part of the 1960s and throughout the 1970s, the relative ease of increasing both sources of revenue and tax rates, gave a false impression of the speed at which the revolution in social and educational programs could be undertaken.

Meanwhile, however, infrastructures were also built for public services which had been seriously neglected in the past. In particular, the network of public highways required enormous sums of money, especially since Québec did not want to lag behind other regions of North America. That did not happen. On the contrary, Québec tended to take the lead.

The net effect of all this was that within twenty years, Québec moved from a state of underdeveloped services to one in which, on the whole, it offers services which are among the best and most numerous in North America. In some cases, they are also among the most costly since, like anything else, acceleration has its price.

And yet, there is still ground to be made up in some areas. There is still a significant gap in one sector which has been neglected for financial reasons and which tends to be very costly: water purification; in the coming years this will require several billions of dollars.

— The government's involvement in economic development

The revolution has been just as brutal with respect to the tools of economic intervention. In 1960, the public sector in Québec was insignificant. Government assistance to business did not extend beyond leasing natural resources.

Government corporations, such as Hydro-Québec, saw their role expanded, while others were set up from nothing to become involved in specific sectors of economic activity. The Société générale de financement du Québec, Sidbec, Soquem, Soquip, Rexfor, Soquia, the Société québécoise des transports, the Société d'habitation du Québec, the Société nationale de l'amiante blazed the trail. Financial institutions were established: the Caisse de dépôt et de placement du Québec, the Société de développement industriel du Québec. In more specific sectors, agencies such as the Société de développement des industries de la culture et des communications or the Société de développement coopératif gradually assumed a role in the financing of firms.

Most of these government institutions quickly learned to work with private firms or the cooperative sector, thus providing business and financial structures which were completely original in North America. It can no longer be said that the role of the public sector is to fill in the gaps left by the private sector, or to operate in basic sectors, or to manage entire sectors of the economy. It has become one of the mainstays of entrepreneurship and is gradually associating itself with other agents.

The simultaneous emergence of domestic entrepreneurship, the cooperative movement (over and above its traditional forms) and of the public sector had, within fifteen years, completely altered the distribution of economic decision-making centres, while the decision-making centres which had been important historically were accelerating their relocation in Toronto.

Building up Québec's public sector was expensive, added considerably to the public debt and thus led to a much greater reliance on the financial markets. Hydro-Québec, whose debt is guaranteed by the government, is the most conspicuous example.

Moreover, the necessary capitalization of the government corporations required a withdrawal of public funds. And, profits being systematically reinvested, the flow of funds remained one way. On the other hand, not all operations were successful. Some government corporations have frequently been in a deficit position. Sidbec is the most visible case, with a deficit which, until quite recently, had to be met by an outlay of public funds from the Treasury of about $100 million every year.

It was also inevitable that government authorities in Québec, since they exercised such an influence over the economy, should gradually assume a role in economic support policies, especially in periods of recession. The most striking example occurred during the recession of 1981 to 1983, when the actual structure of the budget had to be re-worked to introduce effective recovery measures. It was an extremely complex operation to ensure that the economic recovery produced an increase in employment in a context of far-reaching technological transformation, and much more costly than what a simple return to prosperity would have led to believe.

Over and above the shift of resources to Toronto and the West, it must be understood that the system of federal transfers, so useful in the 1960s to camouflage budgetary requirements, had gradually become a veritable budgetary trap.

Some explanations are needed here. Suppose a government in Québec decides to launch public works with $750 million, or to promote an equivalent amount of private investment through subsidies. Suppose that the same government decides to lower taxes by the same amount. Each of these actions is likely to increase economic growth by one percent, which will generate tax revenues of about $150 million. It would then seem likely that the government would return most of that money to the economy to further stimulate growth and that the rest would be applied to income redistribution and protection of its citizens.

Such is not the case. The system of **equalization** and other federal transfers is so designed that over a period of three or four years, the federal government recovers about 50% of the increased resources acquired by the Québec Treasury. The initiatives undertaken by the Québec government would ultimately reduce the federal deficit as much as its own.

This is in sharp contrast to provinces which do not "benefit" from equalization payments, such as Ontario which for every dollar spent in investment or tax reductions, retains 85% of the tax revenues thus generated. The governments of Saskatchewan, Alberta and British Columbia are also directly encouraged to stimulate growth, whereas Québec and the Maritime provinces are not, or very little. If the governments of this last group undertake such steps, they do so only because they are in the public interest.

Given these conditions, is it any wonder that the Québec government, when it has room to manoeuvre, is more inclined to opt for new social programs rather than measures for economic growth through investment or lower taxes? At least the first option will not have the improvement of federal public finances as a main effect. This demonstration will perhaps make it easier to understand Québec's choices since the beginning of the 1981-1982 recession. It was absolutely essential that any leeway be applied to economic growth even if the effects of such stimulated growth on the budget were fairly minimal.

— Reinforcement of national identity

The originality of Québec's economic development "models" is only one of the distinctive characteristics of its society. Despite the periodic efforts to bring Québec back to the Canadian fold, there has never been a time when it has not sought to keep its distance as a separate and distinct society. For several generations, the distinction was maintained at the political level. Today, Québec's spending programs and tax structure set it apart. This policy, or rather, this parallel existence, is costly from many points of view. Each level of government provides a multitude of services and nowhere is the competition of activities aimed at the population as intense as it is in Québec. Moreover, to reinforce this distinctive identity, the gouvernement du Québec must involve itself in initiatives which have no parallel elsewhere in Canada. The unique role of the Québec ministère du Revenu can readily be pointed out. The same could be said for Radio-Québec, for the body of representatives Québec maintains in other countries, which is much more developed that those of other provinces, or the agencies for the protection of the French language.

The two-fold effect of federal-provincial competition and the distinctive aspects of cultural identity add to the already high costs of the rapid transformation of public services and economic policy.

(b) The government as protector: costs and consequences

We have just discussed three factors which have had a direct influence on the growth of expenditures in Québec: the catching up with regard to public services, massive economic intervention and the reinforcement of national identity.

We must now delve in greater detail into what has taken place. There is a common denominator to all these initiatives which explains why, after being so far behind, Québec has involved itself financially to such a degree.

The fundamental principle of public spending, upon which the actions of several successive governments have been based, can be expressed as follows: whether he is a worker, consumer, owner or trade-unionist, the Francophone must be protected. And only the gouvernement du Québec can protect him adequately. When put in these terms, the principle is perhaps somewhat brutal, but it underlies an essential reality. Convinced of the menace which constantly weighs on the survival of the Francophone community, the only government it has must protect it with respect to the rest of the continent.

For a long time, this protection was sought through legal and political means. Over the past twenty years, the budget has been employed to attain the same objective. A few examples will help to explain: years of exploitation of manpower in the public sector led to the belief that if, instead, workers in the public sector were better paid, that would foster a general rise in wages throughout the economy. Public sector employees were thus well paid in relation to those of other provinces and to ensure that the private sector followed suit, significant increases in the minimum wage were enacted in Québec, beginning in the early 1970's, to the point that in June 1975 it reached the highest level in North America. It was only with the severe recession of 1982 that this objective ceased to be an absolute.

Invariably, the essential principle was that with additional resources, Québec could provide additional protection. The Liberal government of 1960 to 1966 demanded the transfer of taxation points. The 1966 to 1970 Union Nationale government wanted exclusive access to the income, profits and succession duties bases, the 1970 to 1976 Liberal government demanded recovery of the entire social security field and the objective of the present sovereignty-oriented government first elected in 1976 has been the complete recovery of tax sources; there has been little change in the argument. More money would mean more protection available to Québec society.

Such an attitude could not help but exert continuous upward pressure on expenditures and, with the shift previously explained, an increased tax burden. Already in 1977, the tax burden of individuals in Québec was more than 20% higher than in Ontario.

The body of protection measures implemented by successive governments in Québec has very nearly produced, in all groups of society, a kind of disincentive to work, to the accumulation of wealth and to progress.

Under a flood of subsidies, local authorities have a much greater incentive to obtain as much government money as possible rather than respond to the true needs of their citizens. Over-taxed businesses end up being convinced that any improvement in their performance is just another encouragement to government to appropriate most of the proceeds of that performance to finance its own apparatus. The disincentive to work is universal among individuals. At the bottom of the income scale, the protection they receive is so good that returning to work would place them in a situation where they lost to the government most of the income they earned. Midway up the scale, the magnitude of income tax discourages effort, while at the top, marginal rates which are unequalled in Canada generate continual protest and pressure even though, as will be seen, it is not always clear that this is justified.

In the background lurks the temptation of black market work and bartering of services which lead to a kind of vicious circle. The longer taxes remain high, the larger the portion of income which escapes any form of accounting and, hence, taxation. Systematized protection leads to a system of loopholes.

D. Fiscal Orientations of the Gouvernement du Québec

Even if the benefits to its finances are negligible, in today's federal context, the gouvernement du Québec should make the growth of the Québec economy the focal point of its deliberations. Québec can take no comfort from allowing the gradual shrinkage of its productive base relative to that of the rest of Canada, even if it is replaced by a more and more extensive social aid and equalization base. In the context of an independent Québec, the growth of the productive base would be central since the budget situation then would finally be a faithful reflection of the growth of the economy, and the ability to redistribute would depend directly on the ability to produce.

The incentive to work and to entrepreneurship lies at the top of this agenda, along with the responsibility of public bodies.

This concern has been developing gradually for many years now, in spite of budgetery constraints which made it difficult to effect solutions.

(a) The reform of municipal taxation

The *White Paper* does not propose to go over familiar ground. Four years ago, a general reform of local government taxation was implemented. The gouvernement du Québec assumed responsibility for virtually the entire cost of primary and secondary education and abolished most of the taxation powers of the school boards, whose expenses had just about become an extension of the government's budget directives. In return, the government opened the property tax field thus vacated to municipalities and eliminated a good number of its subsidy programs. All at once, municipalities became responsible for their revenue and expenditures, while citizens regained a measure of control over municipal finances they had not enjoyed for a long time. Most new projects or programs undertaken by a municipality would henceforth be tied to a decision regarding their property tax rate. Results were not long in coming. The growth rate of expenditures plummeted and for the most part, municipalities in Québec now have sizable budget surpluses.

(b) The reform of business taxation

Business taxation was also completely reformed in 1981. First, government corporations were, for all practical purposes, placed under the same tax rules as firms in the private sector. The oft-heard accusations of unfair competition were, on the whole, well founded.

Above all, the taxation of business firms was reworked. It was desirable on the one hand that the practice of shifting the declaration of profits from one province to another, which had been abused by firms in the past, should be stopped. And on the other, it seemed essential that firms should be encouraged to increase their efficiency, by ceasing to siphon off most of the profits arising from higher efficiency. It was therefore necessary to improve the incentive to invest. In the interest of efficiency, as well, it seemed advisable that all production factors be taxed in uniform fashion. The establishment of a value added tax, as in so many other countries, would have been desirable, but was impossible given the constitutional framework.

This sort of squaring the circle was achieved in the following manner. Employers' contributions to health services were doubled (from 1.5% to 3%). The tax on capital was increased by 50% (to about 3% of the normal yield on capital). To assist firms to bear this new tax structure, in periods when they report losses for tax purposes, a credit for losses may be claimed up to three times the tax on capital, and these taxes and contributions are deductible from taxable income with respect to federal and Québec taxes on profits. Tax on the profits of small businesses was also reduced to 3% and to 5.5% for other companies. In any event, though Québec raised its social contributions, it taxed profits at rates which were by far the lowest in Canada where, for large companies, rates are currently, in the other provinces, 14, 15, or 16% of profits.

At the same time, the Stock Savings Plan was created which, when combined with the subsequent grants paid for a company's initial public share issue, made it considerably easier for Québec firms to gain access to risk capital.

Obviously, this is only a partial reform of corporate taxation, the greater part of which is assumed by the federal government. This field has become extremely complicated and would become even more so should the gouvernement du Québec decide to stake out its own tax bases. It is paradoxical that, should the gouvernement du Québec decide to simplify the business tax base, the tax status of firms would become considerably more complicated since they remain subject to federal law.

In any event, business tax reform has probably gone as far as it can in Québec while remaining compatible with the Canadian tax system.

(c) Personal taxation and the *White Paper*

There remains a general reform of personal taxation. Unquestionably, as will be seen in the Introduction, a whole series of changes have been made in personal taxation since the present government came to power. And these changes are based on a number of fairly simple principles.

However, this is a far cry from saying that the changes brought about up till now are sufficient. They have helped to deal with certain specific problems. They have not gone to the heart of the matter.

In Québec, personal taxation has several basic characteristics which must be modified if economic growth is not to be slowed down.

(a) It is too onerous. As has already been indicated, when the present government took office the tax burden borne by people in Québec was more than 20% greater than in Ontario. Since then, the differential has gradually been reduced, to 8.4% in 1981. However, it was impossible to maintain the spread at this level during the next two years, because of the recession's effects on government finances. It is estimated to be 9% in 1984.

Given the level of services that Québec has provided for itself, given the burden of debt consequent upon the make-up effort of the past twenty years and given the cost of Québec's specific nature, the tax burden of the individual Quebecer will never fall to that of the individual Ontarian. Just as being Canadian rather than American has its price, so there is a price as well as social and cultural benefits to being a Quebecer as compared to a Canadian. At any rate, such is the case in the current political framework which, until it changes, must be seen as a constraint.

But again, the gap must be as narrow as possible.

(b) In the particular case of income tax, the discrepancies are much greater than for the tax burden as a whole. This is reflected in a curve which is more progressive in Québec than anywhere else in Canada. It is well known that, for high incomes, the maximum marginal rate is the highest of any province. It is less well known that this maximum rate is reached at a lower income level than anywhere else. The result is that, as we have already pointed out, at average income levels, tax rates are already high and are increasing rapidly.

(c) The tax system and the system of social transfers are rife with inequities and inconsistencies. Why do most social programs acknowledge de facto spouses, while the tax system acknowledges only legal spouses? Why are the minimum needs of a family in which one spouse works deemed to be different from those of households in which nobody works?

Why is a school-age child in a single-parent household worth nine times as much in the tax system as the child of a two-parent household? Yet, why is it that the head of a single-parent household cannot deduct the full amount of child care expenses, while people who are self-employed may deduct from their income from self-employment the total cost of meals away from home?

The tax laws layered on top of each other over the years bear almost no relation to the laws governing social security programs, and end up producing inconsistencies and, all too often, a disincentive to work.

The *White Paper* is designed as an initial step in correcting this situation. It has no single solution to what is an extraordinarily complex situation. Several options are put forward. In this sense, it could be seen as a Green Paper. And yet, the objectives it mentions are sufficiently consistent that they indicate a general direction which the government favours. They may be attained more or less rapidly or more or less completely.

The discussion which will develop over the coming months will provide an indication of the kind of consensus which can be achieved and on what kind of formula it can be based. All the more so since any useful modification introduced in Québec could be upset by changes brought about in Ottawa. Indeed, it has already been mentioned that, until 1972, the provinces and the federal government shared a common income tax structure. Exasperated by the unceasing demands of the provinces for a greater share, the central government decided to do away with the very notion of sharing and to establish a tax system in which each government would set its own tax burden and would, in fact, tax as it saw fit, if indeed it had the means and the tools. The upshot of this discussion is that Québec may at any time upset the order that either may want to introduce into its system of taxation.

This observation does not render the reform put forward in the *White Paper* any less necessary or urgent. But it does indicate to what extent a tax system will remain unsatisfactory until it is directed by a single government. It will eventually be up to the taxpayers of Québec to decide whether to move in that direction.

In any event, now that Québec's economy is recovering from the paralysis of a deep recession, it is time that a tax system which is both fairer and provides more incentive be established to ensure that in the years ahead the recovery can continue and provide, via taxation, the resources necessary for a gradual redistribution of the income generated. There can be no hope for social justice in a shrinking economy.

Introduction

Introduction

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Introduction

There are two kinds of financial relations between citizens and the State: on the one hand, most of them contribute to the government budget through the various taxes to which they are subject; and on the other, some receive transfer payments from the government, which can be regarded as negative taxation. These financial relations, taken together — between citizens and the State — constitute the essence of this *White Paper*.

A. Development of Québec Tax Policy in Recent Years

Taxation policy, of course, is as old as governments themselves, and has existed as long as governments have had expenditures to finance. There was a major turning point in taxation policy in 1954, when Québec implemented its own personal income tax. This was Québec's entry into a taxation field that nowadays represents the main pillar of its tax policy, and it also marked Québec's reacquisition of the financial autonomy it had not had since 1942, when Ottawa monopolized the field to finance the war effort. This financial autonomy proved to be absolutely essential in the 1960s when there were massive investments to be made in education and health services, and in other expenditures related to the Quiet Revolution. It was in this period, also, that the power to levy retail sales taxes was transferred from school boards (1961) and municipalities (1966) to the gouvernement du Québec.

In 1972, following the recommendations of the Royal Commission on Taxation (*Carter Report*), the federal government completely overhauled the system of direct taxation (personal income tax, corporate income tax, succession duties). The guiding principle of this reform was that all income, regardless of source, should be taxed in a uniform way. This resulted in the integration of the tax system as applied to individuals and corporations, in the taxation of capital gains, in the transfer of the succession duties field to the provinces, in the implementation of a new tax system for mining and oil companies, and in a host of other new tax measures. The provinces had to conform to the tenets of the reform, either because they were bound by tax collection agreements that obliged them to adopt the same definition of taxable income as the federal government, or as in the case of Québec, because its tax laws had to be harmonized with federal legislation for economic or administrative reasons. The framework of the present tax system is still based on this reform, even though numerous modifications have been made in its application since.

When the present Québec government came to power in 1976, it undertook a reform of several aspects of the personal tax system. In succeeding years, various reform measures followed, finally affecting most components of the tax system.

The first measures dealt with the personal tax system. The primary objective was to lighten the tax burden on low and middle-income earners, even if this meant adding to the burden for those who were better off. A secondary objective was to introduce some form of indexing into the income tax structure. While the federal and other provincial governments had been indexing tax tables for a number of years, to avoid taxing the portion of rises in income corresponding to inflation, the previous Québec government had refused to do likewise, so that the personal tax burden continued to increase in Québec.

In 1978, a series of measures were introduced: increasing personal exemptions for spouses, for the elderly and for dependents; indexing all personal exemptions — postponed a year because of the federal-provincial sales tax conflict — and devising a new, more progressive tax rate curve.

The following year, the sales tax was abolished on a number of essential items whose production was concentrated in Québec: clothing, shoes, textiles and furniture. Two years later further exemptions were granted on certain household appliances. At the same time, the reform of the municipal tax system, which made property taxes the basis of the financial autonomy of the municipalities, transferred a net amount of $250 million to municipalities, reduced the burden of property taxes by $100 million to $200 million, and set up a property tax credit to reduce the regressivity of this tax.

By 1980, however, income tax had obviously become so progressive that rates had to be further reduced to avoid certain adverse effects on economic development. An initial reduction of 3% was introduced but the state of the economy precluded continuing the process: a second cut of 2% had to be cancelled. The Stock Savings Plan was set up with the intention of reducing the tax burden for high-income earners, provided they invested in securities issued by new Québec firms. The progressivity of the tax system could be offset in this way, at a moderate cost to the government, and to the very great benefit of firms.

The most recent recession however made it imperative to increase the general tax burden. Therefore the retail sales tax was raised from 8% to 9% and the gasoline tax was doubled. The upswing has now begun, and the gasoline surtax was cut in half in November 1983.

In the interim, however, the MacEachen budget, or rather budgets, upset the balance achieved. The basic idea in the first of these budgets was to do away with a number of tax advantages that benefited high-income earners and, conversely, to reduce the maximum marginal rate from 63% to 50% in most provinces. Discussions and political pressure soon eliminated most of the federal intentions with regard to tax advantages but the new maximum rate was maintained. Québec could not follow suit and, while our maximum rates dropped from 68% to 60% because of Ottawa's action, in other parts of Canada they fell to 50%. The tax burden differential between Québec and Ontario had doubled.

Nevertheless, the primary objective had been largely achieved. A married taxpayer earning less than $25 000 or less than $31 000 (depending on whether he has children under 6 or no children) pays less income, consumption and property tax in Québec than in Ontario.

But problems of growing intensity had appeared. An ever-increasing number of workers who can in no way be considered "rich" are subject to steeper tax rates than elsewhere because of inflation. Many miners, teachers, public service employees, highly productive unionized industrial workers have no reason for rejoicing when they compare their tax burden with that of their counterparts in the rest of North America. The form of indexing adopted in Québec, it must be stressed, is only partial.

High-income earners systematically complain of their high taxes, despite the advantages offered by the Stock Savings Plan. The question must therefore be examined more closely.

Finally, an increasingly serious problem is showing up at the other end of the income scale, created largely by the accumulation of social programs, their mode of operating and their relation with the tax structure.

B. Development of the Policy of Transfers to Individuals

What might be called public charity was started at the beginning of the century when it became clear that private charitable institutions were no longer able to cope with the problems caused by increasing industrialization and urbanization. The programs that were set up then were aimed at specific groups of the poor and disadvantaged: public assistance (1921), old age security (1936 and 1952), assistance for the blind (1937 and 1952), assistance for needy mothers (1937), help for the disabled (1955), and unemployment insurance (1956). After the Second World War the federal government, benefiting from new financial resources, initiated universal income support programs: family allowances in 1945 and old age pensions in 1952. Unemployment insurance was introduced in 1940. At this time, three of the four major kinds of transfer programs for individuals that we have today were already in existence: universal programs, programs based on needs and insurance programs, the fourth kind being assistance to participate in the labour force.

There are three dates in the 1960s to be kept in mind. First, in 1966, the federal government instituted the guaranteed income supplement for needy elderly persons; because of its generosity, it was to replace different provincial programs for this group. The Québec Pension Plan and the Canada Pension Plan were also introduced that same year. In 1967, Québec set up its own family allowance program to replace the tax exemption for children. In 1969 Québec adopted the *Social Aid Act* that revised all the social assistance plans and consolidated them into a single program. The Act embodied the principle of the same poverty threshold for every person or household, regardless of the cause of need: whether able to work or not, everyone was entitled to the same financial assistance from the government, if he had no other income. As the other provinces followed this lead, Canada, along with the United Kingdom, became one of the few developed countries in the world with such a program.

It soon became clear that the system contained some serious disincentives to work, especially in large families, for whom the assistance received was well above the minimum wage, since the amount was set by the State in terms of the whole family's needs, while wages are paid without considering the same real requirements. It was therefore decided as of 1974 to make substantial increases in the universal family allowances for large families, granting the increase for the third and subsequent children, and at the same time reducing the social aid to which they are entitled.

The problem of the incentive to work raised by the transfer system for individuals gradually became manifest in the 1970s. The first assistance programs for those participating in the work force were set up during this period: tax deductions for child care costs and for general work-related expenses in 1972, child care subsidies in 1975, and the employment income supplement in 1979.

Up to this time, the programs of transfers to individuals and the tax policy have developed independently of each other and without real coordination, though the objectives were similar. Both transfers and taxation affect work incentive and income redistribution in society. One after another, year by year, governments have added a series of fiscal and transfer programs without examining each time whether a new measure was consistent with the whole. When employment income increases, the combined effect of reduced benefits under these programs (social aid, the work income supplement, child care subsidy, availability allowance, low rental housing, LOGIRENTE, student loans and grants, etc.) and higher personal taxes is to create a situation in which an individual gains little from his efforts to overcome his position of dependence with respect to these programs.

For example, if the head of a family, with two children under six, living on social aid decides to go out to work for the minimum wage ($8 000 a year), his disposable income will go up from $10 977 to $12 643, a net increase of $1 666. Of the $8 000 he has earned, governments take (in taxes paid and loss of social benefits) $6 334, which means an implicit marginal tax rate of 79%. In other words, of the $4 per hour he received, he is left with $0.83, which is really his net income, but without subtracting the additional expenses incurred to hold a job.[1] If this family also benefited from one of the other specific programs (low rental housing or loans and grants for post-secondary students), in certain circumstances it could happen that, for $1 000 in additional income, the total amount of the gain would be paid back to the government. In that case, the implicit marginal tax rate would then come close to 100% on this extra $1 000.

Furthermore, the development of the transfer system by the successive addition of programs has led to situations which must now be corrected. For example, the same need may be met by two different programs, or by a transfer program and the tax system, or it may only be covered for those citizens who are lucky enough to be eligible. It may not be compensated for at all, even though it is recognized as an essential need by a number of agencies.

The *White Paper* deals with taxation of course. Nevertheless, it cannot avoid dealing with the question of a reorganization of social transfers at some length. It is amazing to think that, out of a concern for ensuring better protection for our poorest citizens, successive governments in Québec have developed the social security system in such a manner that today any attempt by beneficiaries to better their lot is taxed far more heavily than the increase in income of the wealthiest in society. A kind of "poverty trap" has thus been created for a large number of beneficiaries.

It is self-evident that the problems of incentive to work mentioned earlier do not apply in any way to those who are unable to work. However, we may well wonder whether it was advisable at the end of the 1960s to cover both fit and unfit for work under the same benefit structure.

Finally, it may seem somewhat paradoxical to reexamine social transfers on the basis of criteria such as the implicit marginal taxation rate while unemployment remains as high as it is at present. It may be maintained that even if the whole of a social aid recipient's employment income is confiscated when he returns to the labour market, the exercise of questioning the merits of such a system is purely theoretical since so few jobs are available. The answer is that every effort is being made to get the economy going again and create jobs, and that above all, the almost total disincentive which has been fabricated risks making any policy of full employment and full activity illusory.

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[1] If the wages of this family head doubled from $4 to $8 an hour, governments would keep $2.28 of the additional $4. The net wages would increase from $0.83 to $2.55 an hour. The implicit marginal tax rate applied to the extra wages would then be 57%.

C. A New Social and Economic Context

In addition to the government action just discussed, a number of new economic and social developments have called into question various elements of Québec's personal taxation policy. The serious recession from which the world economy is only beginning to emerge has changed many economic, social and budgetary factors. It must be noted that this has been the worst economic crisis since that of 1929, and the drop in employment has affected segments of society where unemployment was virtually unknown. As the recession dragged on, the number of new applicants for social assistance mounted at a staggering rate. In 1982, for example, the number of single men, 20 to 29 years of age and able to work, who applied for social aid increased by 41% over the previous year. The number of all social aid recipients fit for work increased by 22% the same year.

Such a stream of workers fit for work and applying for welfare has major sociological consequences. There may have been a time when there was a social stigma attached to applying for welfare unless one was clearly unable to work, but there has been a decided change. The fact that so many people able to work are asking for assistance makes the situation more acceptable. Hence, the need is even more imperative to set up more effective work incentive mechanisms for the unemployed.

On a broader scale, the whole non-working population is growing out of all proportion: social aid recipients, workers benefiting from unemployment insurance and those who have retired from the labour force without obtaining any assistance from the State, etc. Such a waste of human productive resources is clearly unacceptable. Some way has to be found to bring these people back into the active life of society.

Finally, there have been several structural developments in the past few years that have changed the kind of policies that can be applied. New social values are now developing, and this has induced ever larger segments of the population to adopt behaviour that was formerly considered very marginal. Among them, a new work ethic has had a very direct influence on the tax system.

The effects of the tax and transfer system on the incentive to work and on the social organization of households can no longer be ignored; once considered negligible, they now have far-reaching consequences for public finances. In 1973, 39% of heads of families living on social aid were deemed fit for work; today the proportion is 66%. This means that the increase in the number of social aid recipients is mostly attributable to people able to work, and that this cannot be ascribed solely to the economic recession since this phenomenon has been developing for a number of years. The question also arises as to what has caused a 57% increase in the number of single-parent families in the population during the period 1976-1982, and why 76% of single-parent families whose head is under 30 are living on welfare.

Another major factor that has to be better integrated into our policies is the massive entry of women into the work force. This is no longer a marginal phenomenon, and we have to ask if the tax system takes into account all the additional costs involved in their return to work, particularly for women with children.

On the economic level, there have been new factors that have changed the context to which taxation applies. The development of international trade through mass production, communications technology and progressive lowering of tariffs reduces the margin of manoeuvre governments have in levying taxes in their respective economies. This also accentuates the need for a fiscal system designed in terms of its economic impact.

Moreover, the present state of the world economy calls for a reassessment, for there is no assurance that the rate of growth to which we had become accustomed will continue. But this does not reduce the need for growth: the unemployment rate among young people, for instance, has reached alarming proportions. It would be a mistake to assume that this problem is just another consequence of the economic slowdown, and that it will disappear through the use of the classical techniques for fighting recessions, such as shared work, temporary job creation programs, or increases in public expenditures. There is nothing to be gained by stimulating an economy that has lost its competitive capacity. Québec will have to make its own way in an increasingly competitive world market. And to achieve this, the government must make full use of all potential tools for economic development at its disposal, of which taxation is not the least.

It will also be important for citizens in general to assume a greater responsibility in this fight. The State can never provide the determination and energy which individuals and social groups can apply to the problems confronting them. The State does, however, have a role to play in supporting them, and the reform of Québec's personal tax system should be approached with this in mind.

D. Plan

The *White Paper* seeks to examine personal taxation with a view to adjusting the system to the new realities of Québec's society and economy. The first part is an analysis of the present situation, and the second puts forward various proposals for action or reform.

In the first part, Chapter I outlines the constraints within which the taxation system has to be worked out, and then defines the general objectives of such a system. Chapter II describes the general characteristics of the present tax system and analyses the taxpayer's situation. Chapter III discusses the present system of transfers to individuals, the impact of the tax and transfer systems on economic efficiency and participation in the labour market, and various other problems they raise.

The second part describes the solutions to the problems set out in the first part. Chapter IV begins by laying down the basic principles underlying the reform. In Chapter V, the measures proposed in the reform are presented under five options. These options are not presented as final or definitive, but rather as illustrations of the choices that can be made. The magnitude of the changes involved in the reform is such that they could not be put into effect without a minimum of social consensus. Chapter VI measures the impact of the proposals on the government's budget, on the taxpayers' burden and on the economy. Finally, Chapter VII spells out the nature of the fundamental choices implied by the proposed reform. The government will, however, indicate its own preferences, bearing in mind what changes it feels society is ready to accept.

Part one

Analysis of the Existing Situation

Constraints and Objectives of the Tax and Transfer Systems

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Constraints and Objectives of the Tax and Transfer System

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Chapter I
Constraints and Objectives of the Tax and Transfer Systems

Before passing judgment on Québec's **tax** and **transfer systems***, their objectives and the constraints within which they must operate must be identified. The first section of the chapter deals with the constraints of the system, and the second section with its objectives.

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* Terms in boldface type are defined in the glossary.

1.1 Constraints

The tax and transfer systems must take at least five constraints into account, some of which are particular to Québec. They are:

— the size of Québec's public sector;

— the openness of Québec's economy;

— the tax pressure limit;

— the choice of **tax base**;

— Québec's participation in the federal system.

It should also be borne in mind that every initiative in the fields of taxation and transfers is hampered by administrative difficulties of implementation and that economic conditions, such as those which obtain in the labour market, may influence both the timing and the scope of a proposed reform. This question will be discussed at a later stage.

1.1.1 The size of Québec's public sector

The first objective of the **tax system**, and in a sense its raison d'être, is to ensure the financing of government expenditures. In the case of Québec's public sector this is no small task, since the governments which have succeeded one another in Québec over the past 25 years have chosen to grant a significant role to the public sector. For example, in

Table I.1

Public expenditures[1]
Québec and Ontario
1980-1981

	Level (millions of dollars)		Per capita ($)		
Sector	**Québec**	**Ontario**	**Québec**	**Ontario**	**Differential**
General services[2]	787	546	122	63	59
Personal protection	567	606	88	70	18
Transportation and communication	1 716	1 814	266	210	56
Health	4 275	4 930	664	572	92
Social services	2 768	2 843	430	330	100
Education	5 822	6 431	904	746	159
Natural resources and industry	814	610	126	71	56
Environment	127	299	20	35	− 15
Recreation and culture	232	236	36	27	9
Employment and immigration	119	51	18	6	13
Housing	134	167	21	19	1
Planning and development	128	195	20	23	−3
Debt service	1 222	1 595	190	185	5
Other:					
Régie des installations olympiques	78		12		12
Régie de l'assurance automobile du Québec	103		16		16
Subsidies to local admininistrations	202	417	31	48	− 17
Miscellaneous	14	45	2	5	−3
Total	19 107	20 786	2 968	2 410	558

1. The data, based on the system of financial management, were obtained from Statistics Canada. Adjustments were made to reduce expenditures to a comparable basis. For example, Québec Pension Plan benefits were excluded from Québec's budget, since this area is under federal jurisdiction in Ontario.

2. This item includes primarily spending on the constitutional, political or executive aspects of government activity, management expenses not included under other items, and government contributions to pension funds.

Source: *Secrétariat du Conseil du trésor*

1983-1984, the expenditures of the gouvernement du Québec reached $24.5 billion, that is, 27.2% of Québec's **gross domestic product (GDP)**.

To finance these expenditures, it was necessary to levy taxes during 1983-1984 totalling $15.1 billion, a 16.7% slice of the GDP. The balance was made up by federal transfers and by borrowing on financial markets. In addition to these tax bites there are those of the municipalities, school boards, and federal government, which took some 21% of the GDP (4.3%, 0.3%, and 16.0%, respectively), not to mention the financing of public insurance plans such as those of the Régie des rentes du Québec, the Régie de l'assurance automobile and the Commission de la santé et de la sécurité du travail.

Québec's public spending may be better appreciated by comparing it with that of Ontario, the province which most closely resembles Québec on the economic level, and which is its main competitor as well. The secrétariat du Conseil du trésor has just completed a most informative study on this subject. Table 1.1 charts the results.

From the table one may see that, in 1980-81, on a comparable basis, Québec spent an average of $558 more per capita than did Ontario. For the 6.4 million residents of Québec, this figure represents a supplementary expenditure of $3.6 billion. The main categories of expenditures which contributed to this difference were the following: education ($159 *per capita*), social services ($100 *per capita*), health ($92 *per capita*), general services ($59 *per capita*), transportation and communications ($56 *per capita*), and natural resources and industry ($56 *per capita*).

Moreover, as shown in Table I.2, it seems that the relative differential between *per capita* expenditures decreased from 23% to 18% between 1980-1981 and 1983-1984. Nevertheless in absolute value, the differential continued to rise to stand at about $612 per capita. In comparative terms, this represents an additional amount of some $4 billion to be financed by the Québec government.

The size of Québec's public sector therefore constitutes a major constraint for the tax and transfer systems even though several factors ought to work towards reducing its share of the economy over the coming years. Furthermore, the negative impact of the recession on government finances is going to be reduced as the economy moves into recovery, and the full effects of the government's new income policy and productivity improvement measures have yet to be felt. Despite these efforts, the Québec tax system will still have to produce a higher per capita revenue than Ontario.

1.1.2 The openness of Québec's economy

Québec's economy is relatively small; the gross domestic product in 1983 amounts to some $90 billion, about 2,7% of the GDP forecast for the United States in the same year. It is also a very open economy: approximately 40% of Québec's production is shipped beyond its borders, while imports satisfy roughly the same proportion of its gross demand. In addition, the most striking phenomenon in recent years has undoubtedly been the rapid growth of Québec's exports. Between 1978 and 1983 our international exports increased at an annual average rate of 10,9% and their share of Canadian exports remained steady at 17%. The

Table I.2

Projection of normalized expenditures of Québec and Ontario
($ *per capita*)

	Québec	**Ontario**	**Differential**	
			in $	**in %**
Standardized expenditures in 1980-1981	2 968	2 410	558	23,2
Growth rate of per capita spending between 1980-1981 and 1983-1984[1]	34,3%	40,0%	—	—
Estimated standardized expenditure for 1983-1984	3 986	3 374	612	18,1

[1] Excluding the 431 million in expenditures for future years financed in advance in 1983-1984.

United States and Ontario are by far Québec's most important trading partners, for nearly 70% of our international exports are shipped to our neighbour to the south (Table I.3), while a significant proportion of our total exports is shipped to Ontario.

Table I.4 shows just how open Québec's economy is; a significant proportion of our output is shipped to other provinces of Canada. In 1982, for example, 24,8% of total shipments by the manufacturing sector were for other provinces.

Québec is also a very open economy because of the mobility of physical and financial capital. The mobility of these factors is related in part to the fact that many large manufacturing firms in Québec are basically subsidiaries of multinational corporations and that a large proportion of major Canadian firms doing business in Québec also do so in several other provinces.

Among the exogenous factors likely to affect the growth of such an open economy, one of the most important arises from the multilateral trade agreements concluded in Geneva on April 12, 1979. The GATT agreements, as they are called, stipulate that the negotiated tariff reductions would come into effect in eight yearly stages. The first phase began on January 1, 1980. In the case of Canada, the protective tariffs applicable to industrial products are to be reduced by about 40% at the end of this eight-year period. In addition, since January 1, 1980, aircraft, motors and parts have been admitted free of duty. The tariff reduction is likely to have a significant effect on the degree of openness of Québec's economy.

Under these circumstances, Québec's economy does not have a significant influence on most product markets. It would be difficult for it to export its tax burden by higher prices. Furthermore, the mobility of investment over the long term enables investors to avoid bearing a major portion of this burden. Consequently, it is the least mobile factor, manpower, which in the long run bears almost the entire tax burden.

However, if workers are successful in avoiding part of the burden by negotiating higher before-tax wages, businesses will face higher labour costs, leading to lower employment and production in the private sector and jeopardizing the possibilities of economic growth. This is a major constraint which must be taken into account in any reform of the tax system.

1.1.3 The tax pressure limit

In the short term, an increase in the **marginal income tax rates** raises **tax receipts** but, in the longer term, substitution effects will partially offset or cancel out the increase in tax receipts by lowering the production which is taxed. Raising the marginal income tax rates creates disincentives to work and production of all kinds. It reduces the production which is taxed, that is, which appears on the official market, while increasing untaxed production, through do-it-yourself work, production for barter, under-the-counter payment, and illegal activities. Moreover, such an increase is likely to shift a part of the production into regions not so highly taxed.

Nevertheless the relationship between tax increases and the extent of disincentives to work and production is not linear. For example, an equal rise in the average tax rate will not have the same effect if the initial income tax rate is 20% as it will if the initial rate is 80%. The disincentive will be much

Table I.3

Principal countries of destination for Québec's international exports

	1978		1983		Annual growth rate
	$ million	**%**	**$ million**	**%**	**%**
United States	5 874	65,8	10 424	69,5	12,2
European Economic Community	1 282	14,4	1 736	11,6	6,3
Other	1 774	19,9	2 838	18,9	9,9
Total international exports	8 930	100,0	14 996	100,0	10,9

Source: *Bureau de la Statistique du Québec* greater in the second case. There is also a **marginal tax rate** on employment income which maximizes total tax revenues, in that further increases in the marginal tax rate would reduce the **tax base** to such an extent that total tax revenues would drop. The utility of this concept is to demonstrate the absolute limit of tax pressure.

A recent study on the Swedish economy concludes that the marginal tax rate which maximizes tax revenue is 70%. This is approximately 10 percentage points less than the marginal rate prevailing in that country in the early 1980s[1]. According to the author, this would explain the presence in Sweden over the past decade of pressures by social groups and labour unions to implement maternity and paternity leave, longer vacations, a shorter working week and more part-time jobs.

Similar estimates are not available for North American countries. However, there is no reason to believe that behaviour is so very different here or that the Canadian or Québec tax and transfer systems are not about to reach such a limit, with maximum marginal tax rates running between 50% and 60% and **implicit marginal tax rates** in excess of 80%, as will be seen in chapter III. In a relatively small, very open economy like that of Québec, without borders or tariff barriers between it and the rest of Canada, the absolute limit could well be reached more rapidly. The greater mobility of labour and of the consumption it generates heightens the ability of taxpayers to avoid too big a tax burden.

The harmful effects of high marginal income tax rates are particularly unfortunate, for a highly **progressive tax** system adds very little to efficient redistribution. For example, if all incomes over $45 000 had been taxed at 100% in Québec in 1981, the government would have been able to pay only $404 in transfers to each person 18 or over earning under $45 000.[2] But the disincentives to work and production that would have been created by such a decision would have been out of all proportion. It is preferable to tax less heavily and thus have a broader base to tax.

1.1.4 Choosing the tax base

A tax system which aims to treat taxpayers with the greatest possible **equity** while producing an acceptable **redistribution of income** must levy taxes that increase with the taxpayers' **ability to pay**. Two main lines of thinking have developed over the years with regard to the best criterion for measuring the ability to pay. Some maintain that increased purchasing power is the best measurement of increased individual well-being and therefore of ability to pay. For others, consumption itself is the best indicator.

1.1.4.1 Personal income tax

One definition[3] of income that can be used to measure the ability to pay is based on the net accretion of economic power from one year to the next. It includes remuneration of production factors such as wages, rents, interest, profits, but also gifts, inheritances, gambling profits or capital gains and appreciation in the value of fixed capital assets. This expanded concept of income is equivalent to the total consumption expenditures and change in the value of assets accumulated between the beginning and the end of the period in question.[4]

Table I.4

Destination of manufacturing shipments from Québec

	1978		1982		Annual growth rate
	$ million	%	$ million	%	%
Other provinces	8 629	26,0	2 217	24,8	9,1
Other countries	5 823	17,6	8 940	18,2	11,3
Total shipments	33 146	—	49 183	—	10,4

Source: *Bureau de la Statistique du Québec*

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[1] Charles E. STUART, "Swedish Tax Rates, Labor Supply and Tax Revenues", *Journal of Political Economy*, Oct. 1981, pp. 1020-1038.

[2] If transfers were also made to dependent children, the amount would drop to $294 per person.

[3] Robert Murray HAIG, *The Federal Income Tax*, New York, Columbia University Press, 1921.

[4] Henri C. SIMONS, *Personal Income Taxation*, Chicago, University of Chicago Press, 1938.

This conception of the ability to pay assumes that any form of income, including income from savings, increases the purchasing power and the well-being of the investor. Income from interest and capital gains are considered to be a second income stemming from the individual's decision to save or invest part of the income he originally received and are included in the tax base. In addition, the investor who holds property which appreciates during the year must be taxed on the increased value whether it is realized in liquid form or not. The proposal rests on the argument that, of two persons with the same income, the one who has the greatest net wealth has greater security and a greater ability to pay taxes. Since the distribution of wealth is much more unequal than that of income, including the increase in net wealth in the tax base also makes it possible to achieve a progressive tax system without resorting to overly high taxation rates.

1.1.4.2 Personal consumption tax

A number of arguments militate in favour of further taxing consumption rather than income. First, we can consider that the ultimate end of productive activities is consumption. Second, since resources that are not consumed, but saved, swell the stock of capital required for any investment, it may seem inappropriate to tax a person as long as he has not withdrawn his resources for personal consumption. Furthermore, leaving resources in the collective savings stock is socially desirable since the capital can be used to increase future production. In addition, even if the level of consumption is not a perfect means of determining a person's ability to pay, it is nevertheless the observable phenomenon that is most closely related to the level of individual well-being.

This type of taxation based on expenditure takes the form of a personal tax calculated every year on consumption alone, but not on the accumulation of wealth. The tax rates used may be progressive or not, with or without a system of exemptions. For example, the tax could be just as progressive as the income tax.

1.1.4.3 The North American approach

In Canada, as in the United States, taxation is levied primarily on income, but income defined in a narrower manner than the broadened concept of income just discussed. The tax base does not strictly speaking include the net accretion of wealth and covers the increase in wealth only when the investor disposes of his assets for their cash value. Furthermore, in Canada only half of such capital gains must be included in income for tax purposes and several categories of income are excluded from the base: gains from a principal residence, windfalls, etc.

The choices already made by various governments in North America as regards the method and extent of taxation of wealth constitute a constraint or major limitation to the scope of tax reform that can be undertaken in a small, open economy like Québec's. Even if we were convinced, for example, that it would be more equitable and more efficient to include the full increase in net wealth in the definition of income for tax purposes and lower the marginal tax rates on high incomes, such a reform could prove harmful for Québec's economy if it were undertaken alone. Since wealth is perfectly mobile, savings and investments could be channeled outside Québec to avoid taxes.

With regard to the yearly taxation of consumption expenditures, the Québec government must avoid the use of concepts that are too far removed from those used by the federal government, which would complicate the tax system even further. On the other hand, it would be possible for Québec to place greater emphasis on broader consumption taxes, since this approach would not affect the savings and investment processes. However, it would be necessary to find some way of compensating for the **regressive** aspects of such a form of taxation, and minimizing the transfer of consumption expenditures across the border.

1.1.5 Québec's participation in the federal system

Québec's participation in the Canadian federal system also places some restrictions on the latitude with which the Québec government may shape its own tax system. To avoid creating a tax jungle, the Québec government, with few exceptions, has always maintained a policy of harmonization with the federal government as regards the calculation of business and investment income. Since there is no reason to modify this policy, the resultant problems should be approached by joint action and periodic review, involving the federal government and those of the other provinces.

It is also obvious that any reform of Québec's transfer system must take into account the impact of the federal transfer system on Québec's budget, as well as on its taxpayers. Furthermore, the level of federal government transfer payments to Québec is set by the terms of what is known as the fiscal arrangements system. The existence of this system limits Québec's latitude concerning certain types of expenditures. For instance, social aid payments must be compatible with the Canada Assistance Plan, if the Québec government is to receive transfer payments from the federal government.

In the *White Paper*, our approach has been to take this constraint into account when discussing proposed solutions, in order to make them operational as quickly and effectively as possible. We have chosen to reform Québec's tax and transfer system in view of the particular features of the federal system but to deal only with the part under Québec's control. And there are bound to be difficulties.

1.2 Objectives

The objectives which must be sought by any set of tax and transfer systems can be divided into four categories. It must ensure the financing of public expenditure; it must be as equitable as possible toward all taxpayers and remain relatively easy to administer and understand (general objectives). It must attempt to preserve the competitive position and efficiency of the economy (economic objectives). Finally, it must effect an acceptable redistribution of income by guaranteeing a vital minimum for all and levying a **net contribution** which increases with ability to pay (social objective).

1.2.1 Financing the government's budget

More specifically, this objective concerns the whole tax system in which individuals, enterprises, and government corporations constitute the government's greatest source of revenue. Additional sources of revenue come from other levels of government, the sale of goods and services, return on investments, and other minor sources of revenue. Loans can be seen as another source of revenue for financing the government's budget, though they must be paid off at a later date.

Within the global tax system, individuals constitute the largest group of taxpayers, as they provide more than two thirds of provincial, municipal, and school tax revenues. Therefore, the personal tax system must be designed in terms of the revenue it generates. This is a very pressing objective, and because the level of expenditures to be financed is particularly high, the objective in question becomes a constraint.

1.2.2 General objectives

1.2.2.1 Treating taxpayers with maximum equity

Each taxpayer should contribute his fair share of taxes to finance government expenditures, but determining the fair share is not always easy. In practice, governments have two approaches open to them in deciding the contribution of individuals to the financing of public expenditures. One approach consists in levying on each individual a net contribution proportional to the benefits he receives from the State. Financing specific services, such as highways and public transport, constitutes a partial application of the benefit taxation principle. These taxes may be directly related to use of the service, for example, tolls and complementary commodities such as gasoline.

A second approach is based on ability to pay. Related to this approach is the principle of **horizontal equity**, which means that individuals whose level of well-being is identical in the absence of taxation have an identical ability to pay and should therefore have the same level of well-being after taxation. Taking for granted that income is a good well-being indicator, individuals with the same income must contribute equally to the government's tax revenues, thereby ensuring horizontal equity between taxpayers.

1.2.2.2 A system simple to administer and easy to understand

Simplicity is essential in the tax and transfer systems. Firstly, the administration costs of the system are extremely high: they are of the order of $280 million if one takes into account only that portion of the expenditures borne by the gouvernement du Québec. Any simplification of the tax and transfer systems which lowered these costs would certainly be welcome. Secondly, it is important that the taxpayer understand the objectives pursued as well as the means used to attain them if he is to accept the tax and transfer system, obey its rules, and not be tempted to evade it in one way or another. Thirdly, reaching the objectives of the tax and transfer systems favoured by the government will be easier if the target groups are more easily identifiable. Finally, with respect to personal income tax, a greater number of taxpayers should be able to complete their income tax returns themselves, which will clarify for them exactly how many taxes they pay and transfers they receive, and lessen their dependence on income tax experts in the matter.

1.2.3 Economic objectives

At the same time as financing the government's budget, the tax system must preserve the competitive character of the economy to provide an incentive for economic agents to locate and produce in its territory. In the case of Québec, the task is particularly complex because it is an open economy with little possibility of exporting its tax burden and because it has a relatively large public sector. The tax and transfer systems must also provide for the efficient working of the economy. Generally, when a fiscal measure is introduced, the decision may modify or influence economic choices in a society. An inadequate tax system may prove an incentive for residents not only not to work but also not to save, invest, further their education and upgrade their professional skills. It may encourage them to resort to barter, to work for under-the-counter payments, to choose activities where **tax evasion** abounds or simply to work in illegal activities. The same is true of a transfer system that is overly generous or poorly coordinated.

All these various effects of taxation or transfers on the choices made in the economy will generally reduce its overall efficiency and result in an **economic loss**, that is, the level of collective wealth will be lower than it would be otherwise. Moreover, this economic loss may make it more difficult to attain the objective of income redistribution.

1.2.4 The social objective: an acceptable degree of income redistribution

The well-being of society as a whole is greater if the distribution of wealth or income is not too unequal. There are few societies where such an objective is not pursued to some extent. This objective may be subdivided as follows: first, to guarantee each individual a vital minimum and, second, to collect a net contribution that goes up with a person's ability to pay.

1.2.4.1 Ensuring a minimum standard of living

This objective consists in recognizing that each individual has a certain number of essential needs and ensuring that everyone has sufficient income to satisfy them. The nature and level of such needs obviously vary from one society to another, depending on its climatic, geographic, sociological and cultural characteristics, as well as on its collective wealth and its desire to fight against poverty. In all cases, however, the social objective is to guarantee a minimum income for every person or household in society, so that all can preserve the health and dignity to which they are entitled.

In the tax system, this objective is achieved through **personal exemptions**. The basic exemption, the exemption for a married person and those for dependent children are designed to exclude from taxable income that portion serving to pay for the essential needs of the household. The tax system thus recognizes that the income necessary for satisfying the taxpayer's or his dependents' basic needs is not really disposable income and that, accordingly, it cannot be taxed.

When a household's income from its own resources is insufficient to satisfy essential needs, the transfer system compensates for the discrepancy. In an integrated tax and transfer system, there should of course be a correspondence, for a given category of households, between the level of exemptions and the maximum level of transfer payments to beneficiaries who have no other sources of income.

1.2.4.2 Levying a net contribution that increases with ability to pay

This sub-objective complements the first. It applies to all levels of income above the minimum for subsistence.

Most people believe that a tax and transfer system should be progressive, in other words, that the proportion of income paid to the State by individuals should not be constant but should increase with their income. According to the principle of vertical equity, persons who have a greater ability to pay will pay a larger proportion of their income to the government than others, and conversely the contribution to the State may become negative for those who cannot provide for their essential needs. However, there is no clear, uniform rule as to how progressive a tax and transfer system should be. At issue is a social choice based on the economic and social values given priority by the citizens.

The progressive nature of the tax and transfer system is debated primarily in relation to its economic impact. Some thinkers maintain that a flat rate tax system (in which the tax rate is the same for every income bracket) is preferable to a progressive one because it would reduce the negative impact on the economy to a minimum. Others advocate a very egalitarian redistribution method even at the price of sacrificing a certain amount of efficiency in the economy. The important thing is that it is up to society to decide between these objectives of efficiency and redistribution in order to maximize the well-being of all its citizens.

1.3 Conclusion

This chapter has analysed the principal guidelines according to which Québec's tax and transfer system must be judged. Reform is faced with considerable constraints. The object of the *White Paper* is to examine the consequences of the reconciliation carried out by our society over the years between the different objectives of Québec's tax and transfer system and to present proposals that would make possible a new consensus that is more in line with the realities of today.

Characteristics of the Personal Tax System

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Chapter II

Characteristics of the Personal Tax System

The components of Québec's tax system are personal income tax, **consumption taxes***, municipal and school taxes, succession duties and fees charged for goods and public services. We shall analyse the system in this chapter, with the exception of fees on goods and services.

Although there are no absolute criteria for analysing the structure of a taxation system, three approaches will be used to describe Québec's personal tax system. In the first section, the main characteristics of Québec's global tax system are compared with those in effect in other provinces and countries. Then the main components of this system are discussed in order to analyse the problems resulting from the taxation choices made by successive Québec governments. Finally, the impact of the system on the disposable income of individuals is studied in order to measure its redistributive nature and the extent to which it encourages taxpayers to live and produce in Québec.

Since October of 1980, the gouvernement du Québec has adopted a fee policy designed to pursue one or more of the following objectives, wherever appropriate:

— recovery of all or part of the economic benefit derived from the use of public resources;

— recovery of the cost of issuing and inspecting licences, permits and authorizations;

— recovery of the cost of goods sold or of services provided.

For this reason, revenues derived from fees are only briefly examined in this chapter, and are not affected by the reforms proposed in the *White Paper*.

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* Terms in boldface type are defined in the glossary.

2.1 Comparative Study of Québec's Tax System

In order to illustrate the principal choices made by Québec society in organizing its taxation system, it is useful to compare it with systems elsewhere. The object of this section is to compare Québec with 10 industrialized countries belonging to the Organization for Economic Cooperation and Development (OECD) and with Canada and Ontario, with regard to tax revenues raised in relation to the gross domestic product and to the relative importance accorded to the various sources of taxation in relation to all tax revenues. These comparisons encompass tax revenues of all levels of government in the countries in question (federal, provincial, local and school). Finally, the total **tax burden** of Québec and Ontario taxpayers is compared. The choice of countries and provinces covered by the study was governed by a concern for diversity in economic performance, the extent of their trade with Québec, and the degree of public interest in them.

2.1.1 Comparisons with other countries

Table II.1 shows changes over the past 15 years in the portion of the gross domestic product allocated to the financing of expenditures by the various levels of government in the provinces and countries selected. In 1981, more than half of Sweden's GDP was accounted for by various taxes, while only one-quarter of Japan's GDP went to taxes. Although these data cannot give an exact picture of the size of the public sector — since they exclude government deficits — they seem nonetheless to suggest that the Swedes demanded of their government more and better services than those offered by the Japanese government. In this respect Canada, Québec and Ontario are closer to Japan than Sweden, Holland, Denmark, France or Austria. Indeed, tax revenues in Canada as a whole and Ontario represent about one-third of the gross domestic product in each case, a situation comparable to that of Switzerland and the United States (about 30% and 31% respectively). In Québec, tax revenues account for 36% of the GDP, somewhat below the proportion observed in Germany and the United Kingdom.

Table II.1

Government tax revenues in relation to gross domestic product
Main OECD countries[1]
(in percentage)

	1965	**1971**	**1976**	**1981**	**Percentage increase 1965-1981**
Sweden	35,7	41,2	48,3	51,3	43,7
Holland	35,5	41,7	45,4	45,5	28,2
Denmark	29,9	43,5	41,6	45,3	51,5
France	35,0	35,1	39,4	43,0	22,9
Austria	34,6	36,3	38,5	42,5	22,8
United Kingdom	30,8	35,2	35,6	37,4	21,4
Germany	31,8	33,4	34,4	37,3	17,3
Québec	28,2	34,4	34,4	36,3	28,7
Ontario	29,0	34,3	32,4	33,1	14,1
Canada	26,6	32,4	31,9	32,8	23,3
United States	26,5	28,8	29,3	31,2	17,7
Switzerland	20,7	23,5	31,3	30,3	46,4
Japan	17,8	20,0	21,9	26,9	51,1

1. Countries are listed in decreasing order of their relative size of tax revenues in 1981.

Source: *Revenue Statistics of OECD Member Countries*, Paris, 1983, OECD; Statistics Canada, *Provincial Economic Accounts*, Ottawa, 1983.

The situation is quite different when the growth of the tax burden between 1965 and 1980 is analysed. The tax bite increased the most in relation to GDP in Denmark, Switzerland and Japan, rising the least in Ontario, the United States and Germany. Québec falls between the two groups in this regard.

These results stem from the importance attributed to the public sector by the various countries for the provision of goods and services, and from the need to finance them by raising taxes or borrowing on financial markets. Choices of taxation sources and their degree of use, however, vary from one country to another (Table II.2).

Because of the difficulty of using the same breakdown as that found in the OECD publication, the tax sources used by Québec and Ontario will be discussed later when we examine in greater detail government choices in Québec and Ontario, at the provincial and local levels.

This comparison of taxation sources shows that Canada, like Denmark and the UK, obtained a smaller proportion of its tax revenues through sources of taxation based on production, which are represented by personal income tax, taxes on corporation profits, payroll taxes and taxes on employment, than the other countries. Taxes on production amounted to 56% of total tax revenues in Canada, while in Sweden and the United States they came to 75% and 73% respectively. The use of these production tax sources varied widely; Canada, for example, made greater use of taxes on corporation profits than the average of the other countries, little use of payroll and employment taxes, and average use of personal income tax.

Because of the extent to which **property taxes** are levied by local and provincial governments, Canada is one of the biggest users of taxes on wealth to finance public spending. However, succession duties and gift taxes are virtually non-existent in relation

Table II.2

Breakdown of tax revenues by source as a percentage of total tax revenues in 1981

	Taxes on production				**Taxes on wealth**			**Consumption taxes**				
	Personal income tax	**Taxes on corporation profits**	**Payroll and employment taxes**	**Total taxes on production**	**Succession duties and gift taxes**	**Other taxes on wealth**	**Total taxes on wealth**	**General taxes**	**Specific taxes and duties**	**Total consumption taxes**	**Other taxes**	**Total**
Sweden	39,9	2,9	32,4	75,2	0,2	0,7	0,9	13,5	10,4	23,9	0,0	100,0
Holland	24,7	7,0	40,0	71,7	0,5	3,2	3,7	15,7	8,7	24,4	0,3	100,0
Denmark	52,5	2,8	2,1	57,4	0,4	4,7	5,1	22,9	14,5	37,4	0,1	100,0
France	13,3	5,0	44,9	63,2	0,7	3,0	3,7	21,1	8,6	29,7	3,3	100,0
Austria	23,7	3,3	37,9	64,9	0,2	2,5	2,7	20,1	11,2	31,3	1,0	100,0
United Kingdom	29,4	9,2	20,0	58,6	0,5	12,4	12,9	12,6	15,8	28,4	0,1	100,0
Germany	29,0	5,0	35,5	69,5	0,2	2,4	2,6	17,0	10,1	27,1	0,6	100,0
Canada	33,8	10,5	11,5	55,8	0,04[1]	8,5	8,5	11,0	22,6	33,6	2,1	100,0
United States	37,6	8,6	26,5	72,7	1,0	8,6	9,6	6,3	11,3	17,6	0,0	100,0
Switzerland	35,7	5,9	30,9	72,5	0,7	6,8	7,5	9,4	10,6	20,0	0,0	100,0
Japan	24,7	15,9	30,0	70,6	0,8	7,8	8,6	0,0	15,9	15,9	4,7	100,0

Note: Because of rounding, figures may not add up to the totals shown.

[1] In Canada, only the Québec government levied succession duties and gift taxes in 1981. They represented 0,3% of the total taxes collected in Québec.

Source: *Revenue Statistics of OECD Member Countries*, Paris, 1983.

to other countries. Québec was the only government in Canada to levy such duties and taxes in 1981, when they represented 0.3% of Québec's tax revenues. This proportion is similar to that observed in a number of European countries.

Consumption taxes, duties and licences represent close to one-third of tax revenues in Canada; only Denmark makes greater use of these sources. However, 61% of Denmark's consumption tax revenues come from a **value added tax** applied uniformly to all goods. In Canada, only 33% of consumption tax revenues are produced by the general sales tax. Of all the countries studied, Canada has the most extensive recourse to licences, taxes, duties and fees related to the use of certain goods or engaging in certain activities.

The Western countries figuring in the study have widely differing tax systems, with regard to both the level of taxation and the sources used. It would no doubt be interesting to be able to assess the economic effects of these various tax systems, particularly in the case of neighbouring countries or those forming part of a single trade area. However, comparison of Québec's tax preferences with those of Ontario proves to be even more pertinent.

2.1.2 Comparison with Ontario

Ontario is a neighbouring province whose economic structure resembles that of Québec and is in many respects a very close competitor. In addition, its economic, demographic and political weight in Canada is considerable. This comparison will deal with two questions in particular, the use of taxation sources in each province, and the tax burden differential.

2.1.2.1 Taxation sources

Québec's use of **taxation fields** is quite different from that of Ontario (Table II.3). The main differences arise from the greater importance attributed to taxes on production in Québec, i.e. 42% of total tax revenues as opposed to 30% in Ontario. A

Table II.3

Breakdown of provincial and local tax revenues by source
As a percentage of total tax revenues raised in the private sector under the Québec and Ontario tax systems
1983 taxation year
(in percentage)

	Québec	Ontario
Taxes on production		
• Personal income tax[1]	32,6	23,0
• Corporate taxes[2]	9,0	6,5
Subtotal	41,6	29,5
Health insurance premiums	—	5,9
Taxes on wealth		
• Succession duties	0,3	—
• Municipal and school taxes	23,6	30,4
Subtotal	23,9	30,4
Consumption taxes	27,2	28,2
Provincial revenue from natural resources, royalties and from miscellaneous sources	7,3	6,0
Total	100,0	100,0

1. For purpose of comparison, Québec personal income tax is caculated net of the federal abatement granted to Québec taxpayers. Health insurance premiums levied on working individuals in Ontario are listed as a separate item since it is a *per capita* tax rather than a production tax.

2. Corporate taxes include taxes on corporation profits, the tax on capital, and employers' contributions to the health services fund.

large part of this discrepancy comes from the method of financing health insurance in each province: in Ontario, health insurance premiums are generally levied as a fixed tax *per capita* (in the case of single persons) or per household (in the case of couples and families), while in Québec, the funds required from individuals for financing health insurance come directly from income taxes. If Ontario were to adopt the same mode of financing, the difference in the proportion of revenue from personal income tax in the total tax revenues of the two governments would drop from the 9.6 percentage points observed to 3.7, thereby reducing the difference between the relative proportion of revenue from the tax on production in the two provinces accordingly. In addition, the relative contribution from taxes on companies in the private sector is 2.5 percentage points higher in Québec than in Ontario.

The differences in taxation choices are also apparent in taxes on wealth and personal taxes. Ontario collects 30% of its total tax revenues through municipal and school taxes as opposed to only 24% in Québec. The two provinces are more or less on a par when it comes to the proportion of total tax revenues represented by consumption taxes and specific taxes and duties on goods and services.

It can be seen then, by the extent to which it taxes personal income, that Québec levies more taxes on production than does its neighbour. Ontario obtains a larger portion of its revenue from taxes on wealth and lump-sum premiums than does Québec; most of this differential arises from the fact that Ontario finances education largely from property taxes and health by a tax *per capita* or per household.

2.1.2.2 Tax burden

The comparisons made in the preceding section illustrate the taxation choices adopted by the Québec and Ontario governments. Comparisons of tax burdens enable us to identify differences in rates of taxation, as they are made using standardized tax bases. Thus it is possible to determine whether the amount of revenue collected by a government would have been higher or lower than that collected by its neighbour had their tax bases been comparable. In this way, it is possible to take a more accurate measure of the tax effort demanded of the whole economy and its various components by the government.

The problem inherent in this exercise arises from the need to compare the tax bases of countries and provinces. For international comparisons, we often use the gross domestic product (GDP) as an indicator of a country's general fiscal capability, which allows us to compare the overall tax burden. Data respecting tax bases are easier to come by when the tax burdens of different provinces are compared. The ministère des Finances du Québec undertakes comparisons with Ontario on a regular basis, by applying the Ontario tax structure to Québec economic agents and by comparing the yield thus obtained with the results under Québec's tax structure. The results are published from time to time; however, it is useful to summarize them here.

— Tax burden differential of economic agents in the private sector

Figures in Table II.4 show that in 1977, Québec economic agents in the private sector bore a tax burden which was 14.1% higher than it would have been had Ontario's tax system applied to them. This **tax burden differential** was gradually reduced in 1978 and 1979, reaching 6.9% in 1980. On the other hand, various tax measures implemented in 1981 and 1982 increased the additional tax burden of individual Québec taxpayers by comparison with those in Ontario to 15.4% for the 1982 taxation year; this additional tax burden represented $2 029 million. However, in 1983, the combined effect of the fiscal measures adopted by Québec and Ontario was such that the tax burden differential fell to 9.7%, or $1 440 million.

In light of current economic and budgetary forecasts, and the tax structures in effect after the Ontario and Québec Budget Speeches for 1984-1985 the tax burden differential should drop to 7.8% in 1984, but then climb back to 9.3% in 1985. In absolute terms, these discrepancies will represent $1 633 million in 1985. The drop in the tax burden differential for 1983 and 1984 is temporary, mainly because of the 5% surtax applied by Ontario on personal income tax in 1984. Once the surtax is lifted at the end of 1984, the tax burden differential will climb back to a level approaching that of 1985.

The additional taxes are a vital source of funds required for financing the Québec public sector, along with borrowings and federal transfers. Care must be taken to collect such amounts in the most effective manner possible, with a view to minimizing a potential negative impact on the economy as a whole.

Table II.4 indicates that individuals and business firms in Québec bear a roughly similar greater tax burden, 10.0% and 8.9% higher respectively than Ontario's in 1983. In the case of business firms, their additional tax burden in relation to Ontario showed up in 1981 with the gradual coming into force of the reform of business taxation. Employers' contributions to the health services fund and the tax on capital were raised in 1981 while the rate at which the income of large corporations was taxed gradually decreased until 1983. For 1983, the final year of the gradual implementation of the reform of corporation taxes, the impact of this reform would, however, have brought the level of the tax burden differential on Québec companies back to that of 1980 if certain measures had not been introduced in Québec and Ontario.

The increase in the fuel tax and sales tax rates in Québec, as well as the elimination of income tax for small firms in Ontario, added $415 million to the tax burden differential for 1983, and are the main reasons for the higher corporation tax burden in Québec. The differential is lower for 1984 because of the reduction of the fuel tax from 40% to 30%. With economic recovery, the gap will become narrower still in 1985, since the tax burden of Québec firms depends more on their total payroll and paid-up capital whereas in Ontario, profits bear a relatively greater share of the burden.

Despite this, it would be impossible to reduce the tax burden of individuals by simply transferring it to businesses without taking high risks, especially since the tax base of individuals is three times greater than that of businesses.

— Sources of tax burden differential for individuals

Of the various tax bases to which individuals contribute, Québec's taxpayers are in the best position with respect to municipal and school taxes (Table II.5). The tax burden of individuals in Québec with respect to these bases is actually 12% lower than that of individuals in Ontario, for 1983, because Québec's school boards are almost completely independent of property taxes. There is no equivalent situation in Ontario. Therefore, if the tax structure applicable to Ontario school boards were applied to Québec school boards, they would collect $1 333 million in taxes from individuals compared with the $204 million they now collect. On the other hand, were Ontario to finance education using income taxes as Québec does, the additional burden of Québec taxpayers in this respect would be much lower.

On the whole, the personal tax burden in Québec with regard to consumption taxes is slightly lower than in Ontario. However, considerable disparities between various consumption taxes are observed. Since November of 1983, Québec's tax burden with respect to the gasoline tax is one and one-half times that of Ontario. However, the level of Québec's tax burden is lower than Ontario's for the retail sales tax, restaurant and hotel tax, and the tax on tobacco and alcoholic beverages.

Table II.4

Changes in the tax burden differential of Québec economic agents in the private sector
A comparison of the Québec and Ontario tax systems
between 1977 and 1984

	Individuals		**Businesses**		**Economic agents in the private sector**	
	%	**Millions of dollars**	**%**	**Millions of dollars**	**%**	**Millions of dollars**
1977	20,1	1 100	0,7	16	14,1	1 116
1978	16,0	933	1,2	33	11,2	966
1979	14,1	909	−3,0	−92	8,6	817
1980	9,5	716	1,1	37	6,9	753
1981	8,4	722	7,4	282	8,1	1 004
1982	15,3	1 440	15,7	589	15,4	2 029
1983	10,0	1 062	8,9	378	9,7	1 440
1984	9,0	1 048	4,8	222	7,8	1 270
1985	11,9	1 482	3,0	152	9,3	1 633

With respect to personal income tax, the tax burden in Québec is 24% higher than it is in Ontario. This difference represents an additional outlays of $1 040, which is sufficient to account for the tax burden differential for individuals in Québec. In order to provide a consistent basis for comparison, it should be noted that taxes in Ontario are taken to include premiums for the provincial health insurance plan. In Québec, contributions to health insurance are included in income tax. If these contributions were excluded, the difference in the tax burden with respect to all taxes paid by individuals would rise to 56%.

Mainly because of the reforms carried out in recent years, wealth in the form of property and individual consumption — excluding the consumption of gasoline — is taxed less heavily in Québec than in Ontario. On the other hand, Québec's choices result in a much more progressive personal tax system than Ontario's. While the latter province relies to a greater extent on such regressive taxes as property tax and health insurance premiums, Québec makes use of personal income tax, which is the most progressive of all taxes.

The relatively heavy taxation of production activities has a negative impact on the incentive to produce in Québec. On the other hand, this system results in a higher degree of income redistribution.

Table II.5

Tax burden differential of Québec economic agents in the private sector under the Québec and Ontario tax systems
1983

	Individuals		**Businesses**		**Total**	
	Millions of dollars	**%**	**Millions of dollars**	**%**	**Millions of dollars**	**%**
Provincial revenues						
1. Personal taxes						
1.1 Personal income tax	1 916	56,0			1 916	56,0
1.2 Health insurance premiums	– 876	—			– 876	—
1.3 Total personal taxes	1 040	24,2			1 040	24,2
2. Corporation taxes			503	52,3	503	52,3
3. Succession duties	47				47	
4. Consumption taxes						
4.1 Retail sales	– 151	– 10,5	150	29,4	– 1	– 0,1
4.2 Fuel[1]	359	92,8	204	68,0	563	81,9
4.3 Tobacco	– 101	– 19,6			– 101	– 19,6
4.4 Restaurants and hotels	– 14	– 7,9			– 14	– 7,9
4.5 Alcoholic beverages	– 103	– 18,1	– 126	– 52,5	– 229	– 28,3
4.6 Other	9	28,5	12	35,8	20	32,2
4.7 Total consumption taxes	– 2	– 0,1	240	22,1	237	5,6
5. Revenues derived from natural resources, royalties and miscellaneous sources	303	58,2	– 7	– 1,9	297	33,0
6. Total provincial revenues	1 387	17,5	736	30,4	2 124	20,5
Local revenues						
1. Municipal revenues	803	58,0	175	14,3	978	37,5
2. School revenues	– 1 129	– 84,7	– 533	– 90,0	– 1 662	– 86,3
3. Total local revenues	– 326	– 12,0	– 358	– 19,7	– 684	– 15,1
Provincial and local revenues[1]	1 062	10,0	378	8,9	1 440	9,7

[1] In 1984, the tax burden differential will drop from 10,0% to 9,0% for individuals and from 9,7% to 7,8% for all economic agents in the private sector, as shown in Table II.4. The reduction of the fuel tax rate in Québec and the increase in personal income tax in Ontario account for most of the decline in the tax burden differential. The tax burden differential relative to the tax on fuel dropped from 81.9% in 1983 to 42.5% in 1984.

2.2 Summary Description and Analysis of Certain Problems Raised by the Personal Tax System

Governments initially relied on the tax system solely to finance public expenditures and to distribute the tax burden among the taxpayers. In time, however, the tax system was increasingly used as a means to promote economic and social objectives. Governments implemented their tax preferences by introducing, through the years, a multitude of specific measures in each of the taxation fields affecting individuals. The tax preferences which redistribute the relative tax burden of taxpayers fall into two categories.

The first category of fiscal preferences is characterized by the greater or lesser use of certain taxation fields. Since tax rates vary considerably from one taxation field to another, these choices have a great impact on income redistribution and on the **progressivity** of the personal tax system. Their impact on the personal tax burden will be analysed in section 2.3.

The second category has to do with the tax benefits or relief granted in a taxation field to groups of taxpayers according to type of income, consumption, behaviour, and activities. These tax benefits represent the equivalent of a spending program for the government and, as such, may be considered tax expenditures. The second category of tax preferences is the subject of this section, which will first treat the question of income tax, then consumption taxes, and finally property taxes and succession duties. Lastly, the problem of tax evasion will be discussed.

Before looking at these issues, however, it would be useful to remember that in 1983 the contribution made by individuals to the financing of Québec's public expenditures was of the order of $12 891 million, or 74% of the provincial and local governments' own-source revenue from the private sector, of which income tax, consumption taxes, and municipal and school taxes represent 94% (Table II.6).

2.2.1 Personal income tax

Because of its importance in the financing of government spending, personal income tax is the foundation of the tax system. It determines the distribution of the tax burden among taxpayers and is the government's most versatile tool for achieving social and economic objectives. However, Québec's income tax system causes certain problems of equity and **neutrality** toward taxpayers, notably with respect to the **taxpaying unit**, **income subject to tax** and various tax deductions. This section analyses the major problems of equity and neutrality which are related to personal income tax. The **indexation** of personal exemptions and the taxable income brackets to which marginal income tax rates apply will also be discussed.

Table II.6

Relative importance of the main sources of provincial and local own-source revenue from individuals in Québec
1983

	Millions of dollars	**Percentage**
Personal income tax[1]	6 511	51
Consumption taxes	3 118	24
School and municipal revenues	2 391	19
Succession duties	47	—[2]
Revenues from fees charged for goods and public services	824	6
Own-source revenue	12 891	100

1. Personal income tax includes the portion of revenues associated with the 16,5% abatement in the basic federal tax.

2. Less than 0.5%.

2.2.1.1 Taxpaying unit

The taxpaying unit plays a major role in determining the income tax structure and, as a result its socioeconomic incidence. Three criteria determine the choice of the taxpaying unit: the tax burden should increase with ability to pay, and neutrality must be ensured with respect to marital status as well as with respect to the participation of the spouses in the labour market.

When considering ability to pay, the ideal taxpaying unit is the basic economic unit of society, regarding consumption, saving, investment or borrowing. Common sense, statistical evidence and numerous studies on the subject have shown that, in our society, this basic economic unit is generally the family, that is, single people, childless couples and two-parent and single-parent families. The Carter Commission had this to say on the subject:

> *We believe firmly that the family is today, as it has been for many centuries, the basic economic unit in society. Although few marriages are entered into for purely financial reasons, as soon as a marriage is contracted, it is the continued income and financial position of the family which is ordinarily of primary concern, not the income and financial position of the individual members. Thus, the married couple itself adopts the economic concept of the family as the income unit from the outset.*[5]

However, considering the family rather than the individual as the taxation unit can adversely affect neutrality as regards marital status and the participation of the spouses in the labour market for households with more than one income. If family income (the total income of both spouses) is taxed, the result is, first, a strong disincentive to marry because the application of a progressive tax rates to the spouses' total income adds substantially to their tax burden. Second, there is a strong disincentive for the second spouse to participate in the labour market, since the additional income earned by one spouse is taxed at the marginal rate of the other.

If, in order to circumvent these disincentives, each spouse were taxed on the couple's average income, rather than taxing the couple's total income, then couples having a single breadwinner would have a strong incentive to marry. There would also be a greater degree of neutrality with respect to the participation of women in the labour market. However, such a system of taxation would also imply a systematic under-valuation of the ability to pay of couples with a single breadwinner compared to that of single persons and couples in which both spouses work. The effect would be to replace one inequity by another, not necessarily any more acceptable.

In addition, we should ask ourselves whether it is desirable, in today's society, to adopt a taxpaying unit which accords different treatment to people who are related by marriage, blood or adoption, compared with others whose only tie is that of living together and forming a basic economic unit. In order to take better account of the ability to pay, it would certainly be desirable to treat these latter groups as taxpaying units, but the many legal and administrative problems involved have so far ruled out such a policy.

It is therefore not easy to satisfy all the criteria which have been adopted. Québec settled on the individual as the taxpaying unit because it is the unit which presented the fewest administrative or other difficulties, and because Québec recognized the need for uniformity with the federal system and with other systems in effect in North America. Such a choice may, however, have the effect of overvaluing the ability to pay of households with one breadwinner if the system does not attempt to allow for dependents by means of exemptions, deductions, various allowances or tax credits. The Québec system, with a number of exemptions and allowances for dependents, lies somewhere in between, taking account of the individual's income but in relation to the needs of all dependents.

This choice of the individual as the taxpaying unit appears to be neutral in relation to marital status and to the participation of the second spouse in the labour market. Moreover, it is largely accepted in our society, and is in line with the trend observed world-wide. However, personal exemptions must be made neutral with respect to one or both spouses earning income, since total exemptions currently differ in the two cases. It is also necessary to correct the unfair treatment of persons forming a couple in which one spouse earns more than the other. For households with a given ability to pay, the tax liability is higher when income is unequally divided between the spouses, because of progressive marginal rates.

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[5] Report of the Royal Commission on Taxation, 1966, Vol. 3, p. 123.

2.2.1.2 Income sources for taxation purposes

Québec's personal income tax system generally applies to the same income sources as the federal system. Income sources for taxation purposes essentially include income from employment, income obtained from running a business or exercising a profession, investment income such as interest, dividends and one-half of capital gains, and income from a private pension fund. In addition, some government transfers are taxable: the benefits payable under the Unemployment Insurance Plan, the Canada Pension Plan, the Québec Pension Plan, as well as old age security benefits, excluding both the guaranteed income supplement and the allowance paid to a spouse between the ages of 60 and 65 who belongs to a household where the other spouse is 65 years of age or over.

Although the greater portion of income earned by individuals is subject to tax, there are several important exceptions, with similar results in each case. Individuals who earn income which is not subject to tax receive more favourable treatment than those who, for example, earn employment income. In addition, this unequal treatment could introduce potentially serious distortions into the economy by encouraging an excessive expansion in some untaxed fields of activity to the detriment of those that are taxed.

Non-monetary income makes up a significant proportion of income which is not taxed. This includes the value of household activities or work which a consumer does for himself, such as building his own house. The exemption of this non-monetary income is obviously an incentive to the expansion of this type of outside-the-market economy.

The benefit which an owner derives from living in his principal residence is a second very important category of income not subject to tax where, again, money does not change hands. This benefit corresponds to the imputed income generated by a taxpayer's investment in his residence, which is equal to the value in excess of any mortgage on his house. This exemption is even more important because it is in addition to the exemption from income tax of any capital gain realized on the sale of the residence. It is estimated that a total of $4.4 billion in income was thus excluded from Québec's tax base in 1981, which cost the government alone $1.0 billion in lost tax revenue. It should be noted that this situation confers equal relative benefits on people at both ends of the income scale (Table II.7).

Table II.7

Value of tax expenditures related to main residence in Québec
1981
(in dollars)

Income bracket	**Income exempted, by property owner**			**Tax value of exempted income**[1]	**Tax expenditures as a % of income**	
	Capital gains	**Imputed income from equity**	**Total**		**Property owner**	**All taxpayers**
Less than 10 000 $	2 138	1 253	3 391	474	7.3	2.6
10 000 — 19 999 $	2 409	1 263	3 672	735	4.9	2.2
20 000 — 29 999 $	2 738	1 183	3 921	902	3.7	2.2
30 000 — 39 999 $	3 115	1 346	4 461	1 116	3.3	2.3
40 000 — 49 999 $	3 549	1 533	5 082	1 372	3.2	2.4
50 000 $ and over	4 938	2 285	7 223	2 095	3.2	2.5
Average	2 942	1 378	4 320	1 006	3.7	2.3

1. Capital gains have been entered at 100% of their value rather than at 50% as with other sources of capital gains.

Source: *Ministère de l'Habitation et de la Protection du consommateur*, January 1984.

These tax expenditures related to the principal residence are in line with the government's goal of encouraging home ownership through favourable treatment of this type of investment or savings. Other programs, not related to taxation, also seek to achieve this goal. Moreover, this feature of the tax system is maintained largely because of the government's explicit policy of encouraging home ownership. A further consideration is the difficulty of taxing imputed income from real estate equity since it could only be measured indirectly, either by the taxpayer or the tax authorities. Finally, it would be difficult for Québec to act in isolation in this matter.

Other tax expenditures include the exemption from tax of the first $500 of income from student grants and scholarships, the 50% exemption on capital gains (which is counterbalanced by the 50% allowable deduction for capital losses), and the exemption of the first $1 000 of income from private pensions as well as the initial $1 000 of interest and dividend income (plus, in the federal system, income from capital gains). The inevitable problem raised by these tax expenditures is that of horizontal equity, that is, of imposing unequal tax burdens on taxpayers who have an equal ability to pay.

The result is that the exemption of the first $500 of income from student grants and scholarships benefits only those students eligible for assistance under the program, while those ineligible because of income earned during the summer, for instance, pay higher taxes on the same total income. The favourable treatment of capital gains has a definite influence on the decisions of taxpayers as well as on resource allocation. However, because of the mobility of capital, it would not be an advantage for Québec to act alone in this matter. Moreover, the taxation of investment income such as capital gains, interest and dividend income raises problems of equity during a period of inflation, which will be examined in section 2.2.1.6.

Although there are many other types of income not subject to tax, we conclude this section with government **transfers** to individuals. These include, among others, benefits paid by the Régie de l'assurance automobile du Québec (RAAQ), those paid by the Commission de la santé et de la sécurité du travail du Québec (CSST), benefits payable under the federal guaranteed income supplement to persons 65 years of age or over, the allowance paid to a spouse between the ages of 60 and 64 who belongs to a household where the other spouse is age 65 or over, and social aid benefits.

A taxpayer's ability to pay is certainly maintained by benefits from both the RAAQ and the CSST. However, these payments often compensate the victim for a loss of human capital, hence their exemption may be justified. A tax on these benefits would be a tax on capital and not on income. Moreover, the tax treatment of private insurance plans taken out by individuals themselves follows the same policy. In addition, the level of benefits paid under these plans has been set with their tax-exempt status in mind.

On the other hand, income from such transfers as the guaranteed income supplement, the allowance paid to a spouse between the ages of 60 and 64 and social aid benefits is exempted because of the very nature and goals of these assistance programs. They were designed to provide help for people whose financial resources are inadequate to cover their basic requirements.

Since these transfers generally amount to less than total personal exemptions, there is a problem of horizontal equity brought about by the lack of **integration** between the **transfer programs** and the tax system. For example, while the social aid program responds to the needs of taxpayers on a monthly basis, the income tax system considers only annual income. Thus, individuals who both earn employment income and receive social aid benefits will pay less tax than those whose total income is the same, but is derived solely from employment.

2.2.1.3 Deductions and exemptions

A number of deductions may be considered in the calculation of **taxable income** under Québec's present tax system. In this *White Paper* they have been divided into the following categories: those related to essential needs, those incurred to earn income, those related to studies and those related to economic or other objectives.

— Expenses related to essential needs

To avoid taxing individuals on income needed to cover their essential needs and those of dependents, the tax system provides several personal exemptions or refundable tax credits. Both types of measures, which have essentially the same objective, do, nonetheless, have their own characteristics.

The personal exemption protects all taxpayers, regardless of income, from paying tax on the same amount of income, corresponding to the taxpayer's, or his dependents', subsistence expenditures. As the exemption applies to income rather than tax, it permits taxpayers subject to higher marginal rates to make greater tax savings, as shown in Graph II.1. For example, a $100 exemption could represent a tax saving of $33 for a high-income taxpayer, and only $13 for a low-income earner.

The refundable tax credit, or an equivalent allowance, may also be employed in order to take into account the taxpayer's essential needs, and those of his dependents. The reduction in tax then represents a fixed amount rather than one which increases with the taxpayer's income. The tax credit is preferable to the personal exemption if the redistributive nature of the tax system is to be emphasized.

However, for the government, the choice between the exemption and the tax credit is a significant one. To avoid taxing individuals on that part of income used to cover essential needs, the credit will cost much more than an exemption. In the last instance, the amount of the credit should be equal to the value of the personal exemption for those taxed at the maximum marginal tax rate. For example, when a $100 exemption is converted into a credit at the maximum marginal rate, the tax credit must be set at $33.

This procedure proves to be onerous for the government, because all individuals not taxed at the maximum rate would obtain a tax reduction greater than the value of the exemption. A tax credit equivalent to the essential needs of children, but converted at the maximum marginal rate, would cost 1.8 times more than an exemption covering the same needs.

To reduce its cost, the credit could be reduced. However, this would lead, on the one hand, to the redistribution of income among families with dependent children towards low-income families and, on the other, to an increase in the tax burden of high-income families with dependents, in relation to high-income taxpayers without dependents.

Graph II.1 illustrates both effects. For example, if, in order to take into account a dependent's needs, a $100 exemption is converted into a $23 tax credit, taxpayers subject to marginal rates over 23% (that is, anyone with a taxable income over $15 000) would pay tax on the income necessary to cover a dependent's essential needs. This is equivalent to a surtax on part of their income. It is used to pay the amounts above and beyond the value of the exemption for low-income taxpayers who also have a dependent. Thus, it constitutes the redistribution of income among taxpayers who must assume the cost of a dependent's needs.

Other taxpayers without dependents are not affected by such a change, if this conversion is effected at zero cost. Where they have high incomes, they will not pay the surtax which is imposed on taxpayers with a dependent; consequently, given the same ability to pay, high-income taxpayers without dependents will bear a lighter tax burden than those with dependents.

The **disposable income** of individuals who are not taxed and receive social aid benefits or the employment income supplement will not be affected by the conversion of a tax exemption into a tax credit, or vice versa. Their benefits are established on the basis of their own essential needs, and those of their dependents. Where credits or allowances are paid to their dependents, benefits would be reduced proportionately.

To conclude, the choice between a system of tax credits or exemptions does not affect individuals benefiting from transfer programs. However, this choice has an impact on the redistribution of income among taxpayers with dependents, and on fairness with respect to middle and high-income taxpayers with, or without, dependents.

The Québec system of taxing personal income recognizes that the ability to pay of a taxpayer is reduced by his obligation to cover essential needs for himself and his dependents. To this end, it provides for exemptions as well as allowances which vary in accordance with the family situation and age of the dependents (Table II.8). The two methods of recognizing expenses related to essential needs are thus used in the Québec system.

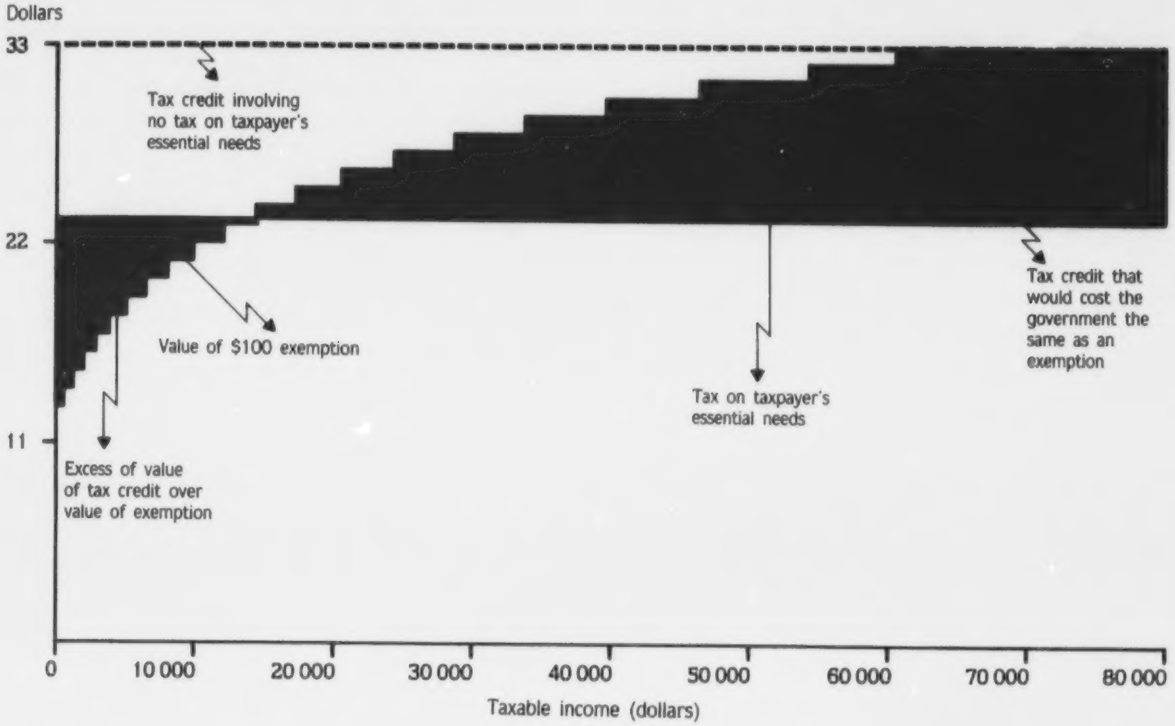
▪ The taxpayer and his spouse

For the 1983 taxation year, every taxpayer in Québec is entitled to a basic personal exemption of $5 030 for his essential needs. In addition, a $100 standard deduction maybe claimed in lieu of the deductions for charitable donations and medical expenses. A married person is granted an exemption of up to $3 770 if the spouse does not have sufficient resources for his or her essential needs.

A basic personal exemption higher than the spouse's exemption implicitly recognizes a higher cost for essential needs for the first spouse. However, when both husband and wife earn income,

Graph II.1

Value of an exemption and a tax credit in relation to taxable income



the sum of their personal exemptions ($5 130 + $5 130) is higher than that of a household where only one spouse does so ($5 130 + $3 770); thus, for the same level of household income, the tax system imputes a lower ability to pay when income is earned by the two spouses. It may be acknowledged that the ability to pay of a household in which both spouses are on the labour market is lower, for a given income, than that of a household where only one spouse is working, because of the additional household maintenance costs involved in this double participation. But such an argument does not apply when income from other sources, such as **investment income**, is considered.

Furthermore, the dependent spouse's exemption is not reduced for the first $1 360 earned by that spouse. This may enable the household in which the second spouse earns an income of $1 360 or more to accumulate the same amount of exempt income ($5 130 + $3 770 + $1 360) as two individuals ($5 130 + $5 130). However, the problem of equity remains when one compares the ability to pay of the taxpayer whose spouse, for example, has an income of $1 000 with that of another taxpayer whose spouse earns nothing. The tax system attributes the same ability to pay to them even though their total household income is different. Furthermore, this level of exempt income, like those for dependent children and other dependents, may lead to tax evasion. Untaxed taxpayers may issue receipts to those who have tax liability and who claim them as deductible expenses (e.g. for child care costs).

The spouse's exemption is granted to persons who are married at the end of the calendar year without taking account of the time interval since the ceremony, while the income which reduces the exemption is that earned since its date. If the complete exemption continues to be granted for a spouse who is dependent on a taxpayer for only part of the year, the full year's income of this spouse should also be considered, including the portion earned before the date of the ceremony.

Table II.8

Exemptions for dependents, allowances and tax credits
1983 taxation year
(in dollars)

	Québec System	**Federal System**
1. Exemptions		
Basic personal exemption	5 030	3 770
Standard deduction	100	100
Exemption for dependent spouse		
Married person's or equivalent exemption	3 770	3 300
Maximum spouse's income not affecting the exemption	1 360	570
Exemption for children		
Under 16		
— Exemption	—	710
— Maximum dependent's income not affecting the exemption	—	2 450
— Taxation of family allowance		
Federal	No	Yes
Québec	No	No
16 and 17		
— Exemption	770	710
— Maximum dependent's income not affecting the exemption	2 800	2 450
— Taxation of family allowance		
Federal	No	Yes
Québec	No	Yes
18 and over		
— Exemption	1 260	1 300
— Maximum dependent's income not affecting the exemption	2 800	2 570
Exemption for other dependents	1 260	1 300
2. Tax Credits and Allowances		
Tax credit for children under 18		
Credit per child for households whose income does not exceed $26 330		343
Rate of reduction of credit beginning at household income of $26 330		5%
Family allowance (children under 18)		
• Basic allowance per child		
first child	90,24	205,44
second child	120,60	326,28
third child	150,60	794,16
fourth child	180,60	794,16
• Additional allowance per child between 12 and 17	—	85,56
• Average allowance per child	110	342

- **Dependent children**

The Québec tax system has provisions that differ according to the ages of the children: those under 16, those 16 and 17 and those 18 or over. Instead of granting a $710 exemption for dependent children under 16 and taxing federal family allowances, which average $342, as is the case in other provinces, Québec pays family allowances of an average of $110, which are not taxed by either the federal or the Québec tax system. Thus, instead of an actual exemption of $368 as offered by the system in the other provinces, Québec grants an allowance equivalent to a $344 exemption (1983) for a taxpayer subject to the maximum marginal rate. The family allowance, as envisaged in the reform of 1974, plays the role of a refundable monthly tax credit.

A taxpayer with dependent children 16 or 17 years of age benefits from two provisions in Québec's tax system, an exemption of $770, which is reduced by that portion of the dependent child's net income (as understood within the income tax system) exceeding $2 800, and a family allowance of $110 on average which, as we have just seen, is equivalent to a $344 exemption for a taxpayer at the maximum marginal rate. The two provisions represent the equivalent of an overall exemption of $1 114. However, the Québec family allowance paid for children aged 16 or 17 is taxable in the federal system, since an exemption for dependent children is also granted by Québec. This reduces the $710 federal exemption for dependent children of 16 or 17 by about $110.

Finally, taxpayers are granted an exemption of $1 260 for dependent children aged 18 to 20, and those 21 or over if studying or disabled. This exemption, too, is reduced for a dependent child's net income (as understood within the income tax system) exceeding the exemption level of $2 800.

The system thus treats dependent children differently depending on their age. For those under 16 it pays family allowances instead of an exemption for dependent children, while for those of 16 and 17 it grants both an exemption and the family allowance. For dependent children 18 or over, there is a higher exemption and the family allowance is no longer payable.

In addition, the family allowance system is graduated to pay an amount that goes up with the number of children in the family. This system makes it possible to reduce social aid benefits to large families to a level which does not exceed the minimum wage, so that these benefits do not act as an inducement for the head or members of these families not to enter the labour market.

This graduated scale assumes that, for families not receiving social aid, the needs of a first child are not as great as for a second, and that the needs of a third child are greater than those of the first or second, which is contrary to the facts. The family allowance system in Québec is an example of the government's intention to achieve a number of objectives together: to foster a higher birth rate, to encourage low-income families to work, not to tax income required to meet children's essential needs, to redistribute income by transfers to low-income families and to pay allowances to mothers.

Finally, the essential needs of the first three dependent children recognized by the present tax system are lower than in the social aid program. In fact, the essential needs recognized by the social aid program for a dependent child between 6 and 11 in a two-parent family come to $1 300. But as we have seen, the amount recognized by the Québec tax system for a child under 16 is $344 on average, including the effect of family allowances.

A further problem arises from the equivalent to a married person's exemption granted for the first child to the head of a single-parent family. It is not neutral with respect to the organization of the household since it entitles a dependent, for instance a very young child, to an additional exemption if he belongs to a single-parent family rather than a two-parent one or if his parents are de facto spouses rather than married. A family with two children, in which each spouse earns $20 000, will pay a total of $7 960 in taxes and contributions if they are married, and $5 010 if they are two single-parent families, a $2 950 reduction in the tax burden. There is thus an obvious financial advantage for a family with two children, in which both spouses work, to be recognized as single-parent families by the tax system. This problem would be partly solved if the tax system treated legally married spouses and de facto spouses on the same footing.[6] What is in fact a single family would no longer be regarded as two single-parent families. However, this measure would not solve the problem of equity inherent in the equivalent of married exemption granted for a child in an authentic single-parent family.

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[6] Doing so would also have the advantage of ending the unfavourable treatment of the de facto partner who is actually dependent, and for whom no exemption may be claimed.

Québec's tax system, then, considers dependent children in a manner that is highly complex, and not always consistent, with respect to different types of household or family organization.

• Other dependents

A taxpayer who supports a dependent other than his spouse or child may be entitled to an exemption for other dependents. Generally the level and eligibility conditions are similar to those for a dependent child. The taxpayer must be allied to this person by ties of blood, marriage or adoption. The person may be a grandfather, grandmother, father or mother dependent on him because of a physical or mental infirmity, a brother or sister if they meet the same criteria as a dependent child, a niece or nephew if the mother is widowed, divorced or separated and does not receive support for the child, or if the father suffers from a mental or physical disability.

However, a single, separated, divorced or widowed taxpayer may be entitled to an exemption equivalent to that of a married person for such a relative who lives with him and is entirely dependent on him, instead of the exemption for other dependents. As in the case of a dependent child the tax system recognizes essential needs that differ for the same dependent in accordance with the type of household organization.

• Persons 65 years of age or over

More and more persons aged 65 or over have been able to make suitable financial preparations for their retirement. This financial planning is greatly assisted by exempting income invested in pension or retirement plans from tax, and by benefits paid by the Québec Pension Plan and the federal Old Age Security Pension, in particular the latter, which is a universal program. When taxpayers reach the age of 65, they may also benefit from special exemptions or deductions on top of the regular exemptions.

The most important of these exemptions is the age exemption of $2 100 granted to taxpayers 65 or over. The relationship between this exemption and the additional essential needs of older persons is not clear since their additional needs are primarily related to health care and are already met by other specific aid programs (free drugs, for example).

In addition to the $2 100 age exemption, persons 65 or over also benefit, like other taxpayers, from some exemptions and deductions not related to the coverage of essential needs. These are the deductions of the first $1 000 of income from private pension plans and of the first $1 000 of income from interest and dividends. There is also the transferability from one spouse to the other of the age exemption.

Since the institution of a larger number of programs of assistance for elderly persons, it seems difficult to justify the idea that the ability to pay of such persons is lower than that of persons under 65 with the same level of income. In particular, since the April 1982 amendment to the *Act respecting labour standards*, it has been impossible to force a person between 65 and 70 to leave his job because he has reached the age of retirement.

• Disabled persons

Disabled persons also benefit from a specific $2 100 exemption. It is easier to justifiy this exemption. Ideally, it would undoubtedly be more equitable if the actual costs related to the additional needs of such persons were deductible on presentation of vouchers. But an exemption is much simpler to administer. Nevertheless, if the principle of the exemption is to be preserved, a disabled person should be entitled to claim a further deduction if his additional costs for holding a job, or for meeting his essential needs exceed the amount of the exemption. Also, sufficient administrative integration must be ensured to prevent a taxpayer from being able to claim a disabled person as a dependent when that person is supported by the State. For instance, it is conceivable that transfers from the Régie de l'assurance automobile du Québec and the CSST be used to reduce the level of this special exemption. This exemption may be claimed by the handicapped person or by the person responsible for him.

There would also be grounds for extending the exemption to persons suffering from a mental infirmity. At the present time only persons who are physically disabled are entitled to such an exemption.

Personal exemptions should therefore be reviewed to provide for greater integration of the tax and transfer systems and greater conformity with the objectives sought. The question of the level of personal exemptions will be discussed in Chapter III when we deal with the essential needs of various categories of taxpayers.

— Expenses incurred to earn income

Generally speaking, the Québec system taxes earned income after deducting the expenses incurred to earn it. There are many kinds of deductible expenses. However, the impact of only certain expenses will be analysed in the *White Paper*: those related to providing care for young children and general expenses related to in holding a job.

• Expenses related to the care of young children

The principal cost of entering the labour market is the cost of child care, even though this cost is borne by only part of the population. Québec's tax system grants a deduction for the cost of care for children under 14 which can be claimed by the parent earning the lower income. The deduction however cannot exceed $2 000 per child and $6 000 per family, or two thirds of the taxpayer's earned income (Table II.9). Moreover, families with children under 6 may choose between the child care deduction or the availability allowance, whichever is more advantageous; the latter may be claimed even if child care expenses have not been paid.

The deduction for child care poses a number of problems, the most important of which is its excessively low level in relation to the real costs of day care. A permanent job often demands 260 days of work during the year, and day care centres may charge $12 per day. This means a total of $3 120 for child care expenses, while the maximum deduction allowed is $2 000. This represents not only a serious problem of fairness for this category of taxpayers as compared to others, but also an obstacle, for the head of a single-parent family or for the second spouse of a two-parent family, to entering the labour market, primarily for women.

Another problem with this deduction is that it can only be claimed by the person earning the lower income. Why not the one who earns the most?

Another difficulty with the child care deduction is the lack of relationship between its level and the child's age. In this regard, while the present ceiling is often too low for pre-schoolers, it may also be too high for school age children whose care is assumed by the school for most of the day.

The availability allowance, set at $300 for the first child under 6, $200 for the second and $100 for each of the others, is intended to recognize the cost related to the presence of children, whether care is provided by one of the spouses who remains at home, or is entrusted to someone outside and paid for to enable both spouses to enter the labour market. It is possible that this allowance is used primarily by spouses who remain at home, since the others find it to their advantage to claim the deduction for child care costs. However, since this allowance ceases when a person reenters the labour market and chooses to claim the deduction for child care costs incurred, there is reason to believe its impact as an incentive to work is somewhat negative. An increased deduction for the cost of care for children under 6 would certainly have a greater positive impact on participation in the labour market.

• General expenses related to holding a job

For taxpayers earning income from self-employment, expenses related to their business may be deducted from their business income. Persons earning employment income are entitled to a standard deduction of 3% of their employment income with a maximum of $500. The expenses covered by this deduction are the general basic expenses incurred to hold a job: transportation costs, extra costs for meals at work, extra costs for clothing, tools not furnished by the employer, etc.

The goal of this standard deduction is to make the tax system more equitable for wage-earners or employees in relation to those receiving business income, for whom such expenses are deductible on presentation of receipts. However, since the $500 limit has not been increased since 1978, there is good reason for thinking that the amount of the present deduction is not high enough, and that a study to determine the real level of employment-related costs should be undertaken.

• Other expenses related to holding a job

In addition to tasks related directly to their job, taxpayers must perform others related to their own maintenance and to that of their dependents, such as domestic and home maintenance tasks. These tasks are more numerous when there are children in the household and increase with the family size. Thus, the tax system encourages taxpayers to do this work themselves, for they will not be taxed on its value and will not have to pay for it out of income on which they have already

Table II.9

Deductions and allowances related to expenses incurred to earn employment income
1983 taxation year
(in dollars)

	Québec System	**Federal System**
1. Deduction for child care expenses for dependent children under 14		
— maximum deduction per child	2 000	2 000
— maximum deduction per taxpayer or two-thirds of earned income	6 000	8 000
— taxpayer who may claim deduction	the one earning the lower income	the one earning the lower income
or		
Availability allowance for dependent children under six		
— first child	300	—
— second child	200	—
— third child	100	—
2. General deduction from employment income		
— rate of deduction	3%	20%
— maximum	500	500
3. Deduction of unemployment insurance contributions		
— rate of contribution	2.3%	2.3%
— exemption[1]	4 004	4 004
— maximum insurable earnings	20 020	20 020
— maximum contribution	460.46	460.46
4. Deduction of contributions to QPP or CPP		
— rate of contribution	1.8%	1.8%
— exemption	1 800	1 800
— maximum pensionable earnings before exemption	18 500	18 500
— maximum contribution	300.60	300.60
5. Deduction of union and professional dues	Expenses incurred	

1. No contribution for earnings equal to or less than 20% of the maximum insurable or contributory earnings.

paid taxes. Moreover, the costs incurred if such tasks were done by others would not be deductible.

When there are children, these tasks may prove very heavy and households frequently choose to entrust them to one of the parents who has deliberately chosen not to enter the labour market. On this basis, the tax system does not favour the participation in the labour market of the second spouse or the head of the single-parent family. A tax system that allowed for deduction of this type of expense for a second spouse or single-parent family head participation in the labour market would be more neutral with respect to such participation.

It would therefore be useful to re-examine a number of tax expenditures related to holding a job, either to restrict them, to broaden them or to improve their administration.

— Expenses related to studies

In addition to his essential needs, a student must defray certain other expenses related to his studies: tuition fees, for instance, and the additional cost of lodging if the student must move away from the family home to attend an educational institution.

All the amounts required to meet essential needs and expenses related to studies are generally assumed by the State, the parents or the student himself, in varying proportions.

The level of essential needs recognized by the present tax system varies considerably according to whether the student is supported by his parents ($1 260) or is on his own ($5 030). This situation does not appear to be justifiable and consequently the present system does not entirely recognize essential needs in the case of a student who is financially dependent on his parents.

As regards tuition fees and general expenses related to studies, only the former are deductible for tax purposes. Nor may they be carried over from one year to the next, or transferred to the parents, even when the student assistance program admits that the parents have paid them considering their presumed level of contribution to their children's needs. The tax system should therefore reserve a better fate for this type of expense, which is in fact an investment in human capital with a view to earning an income in the future.

— Measures related to economic or other objectives

A number of other fiscal measures reduce the amount of tax payable by taxpayers. Some serve to defer the taxation of income until after retirement to facilitate financial planning. Others are connected with running a business, investments or particular activities. They are not dealt with in the *White Paper*, for they are generally found in the tax systems of the other provinces and the federal government; any changes, if desirable, could only be made through a reform of the Canadian tax system. However, it should be noted that all tax expenditures which are not related to a taxpayer's ability to pay make it possible for some high-income taxpayers, using tax planning or other means, to significantly reduce or even eliminate their income tax.

The data published in the tax statistics of the ministère du Revenu cannot be used to assess the significance of this phenomenon. The concept of total income they employ does not take certain deductions into account (investment losses, alimony payments, business and capital losses from other years, etc.) which have an effect on the ability to pay tax. The tax statistics therefore tend to overestimate the real income for these taxpayers. When the concept of total income employed in the tax statistics is modified so as to take account of the deductions affecting ability to pay, it is found that three quarters of the taxpayers who, according to the tax statistics, earn high incomes (over $45 000 in 1982) but pay no income tax, have been incorrectly classified. In the same way, one quarter of these same taxpayers earning at least $45 000 in 1982 and whose average income tax rate was less than 10%, would not have been classed as high-income taxpayers if the concept of total revenue had been changed.

Nevertheless, the fact remains that there are high-income taxpayers who, despite their ability to pay, contribute nothing in income tax. Given this situation, there is good reason to ask whether a minimum tax should be collected on taxpayers at the high end of the income scale to ensure that they make at least some contribution to financing government expenditures. Another possible solution would be to impose a limit on the total amount of tax expenditures a taxpayer may claim for a given taxation year. The issue should also be taken up jointly with the federal and provincial governments so that Québec does not act alone.

Table II.10

Personal income tax table under the Québec tax system, 1983
(in dollars)

Taxable income	Tax at lower limit of bracket		Tax rate within bracket (%)	
	without 3% reduction	with 3% reduction	without 3% reduction	with 3% reduction
0 — 577	—	—	13	12,61
577 — 1 244	75,01	72,76	14	13,58
1 244 — 2 015	168,39	163,34	15	14,55
2 015 — 2 906	284,04	275,52	16	15,52
2 906 — 3 936	426,60	413,80	17	16,49
3 936 — 5 127	601,70	583,65	18	17,46
5 127 — 6 504	816,08	791,60	19	18,43
6 504 — 8 095	1 077,71	1 045,38	20	19,40
8 095 — 9 935	1 395,91	1 354,03	21	20,37
9 935 — 12 061	1 782,31	1 728,84	22	21,34
12 061 — 14 519	2 250,03	2 182,53	23	22,31
14 519 — 17 360	2 815,37	2 730,91	24	23,28
17 360 — 20 644	3 497,21	3 392,29	25	24,25
20 644 — 24 441	4 318,21	4 188,66	26	25,22
24 441 — 28 829	5 305,43	5 146,27	27	26,19
28 829 — 33 902	6 490,19	6 295,48	28	27,16
33 902 — 39 766	7 910,63	7 673,31	29	28,13
39 766 — 46 544	9 611,19	9 322,85	30	29,10
46 544 — 54 380	11 644,59	11 295,25	31	30,07
54 380 — 60 714	14 073,75	13 651,54	32	31,04
60 714 and over	16 100,63	15 617,61	33	32,01

2.2.1.4 Tax liability

Under Québec's tax system, increasing tax rates are applied to the taxable income which is first reduced by various exemptions and deductions, to determine the amount of tax payable. Then a general tax reduction of 3% is applied to the amount of tax calculated. Table II.10 shows the 1983 tax rates in Québec, with and without the general reduction of 3%.

Under the federal tax system, the amount of tax liability depends on whether the taxpayer resides in Québec or in another province, even if the federal tax liability is basically the same in each province. Quebecers benefit from a **tax abatement** equiva-

Table II.11

Personal income tax table under the federal tax system, 1983
(in dollars)

Taxable income	Basic federal tax		Basic federal tax after deduction of the special 16.5% abatement for Québec	
	Tax at lower limit of bracket	Tax rate on income within limits of bracket %	Tax at lower limit of bracket	Tax rate on income within limits of bracket %
0 — 1 179	—	6	—	5,01
1 179 — 2 358	71	16	59	13,36
2 358 — 4 716	259	17	216	14,20
4 716 — 7 074	660	18	551	15,03
7 074 — 11 790	1 085	19	906	15,87
11 790 — 16 506	1 981	20	1 654	16,70
16 506 — 21 222	2 924	23	2 442	19,21
21 222 — 33 012	4 009	25	3 348	20,88
33 012 — 56 592	6 956	30	5 808	25,05
56 592 and over	14 030	34	11 715	28,39

lent to 16.5% of the basic federal tax. The value of this abatement is recovered by the federal government when calculating transfers to the Québec government as it is subtracted from amounts otherwise payable. Since its withdrawal in 1964 from shared cost programs, the Québec government in turn compensates for this reduction by using the tax field thus freed by the 16.5% abatement. Table II.11 presents, for the 1983 taxation year, the basic federal tax rates and the rates reduced by the 16.5% abatement.

The tax table under the Québec system is progressive, marginal rates before reduction moving from 13% for the lowest income bracket to 33% for the highest. Such a table represents the main instrument used by the Québec government to achieve redistribution of income. It is however difficult to assess the impact of such a table without taking into account the tax system when applied, as a whole, to individuals and without taking the choices of neighbouring states or provinces into account. This will be discussed in section 2.3.

2.2.1.5 Property tax refund

Under the present tax system, low and middle-income households are eligible for a partial refund of municipal and school property taxes paid with respect to their main residence. The formula currently in effect provides for a refund of up to 40% of property taxes paid during a given year (to a maximum of $400), depending on total household income. However, this amount is reduced by the equivalent of 2% of the basic income earned by the household during the same period. The basic income used to caculate the refund is equal to 90% of total household income, less personal exemptions. Occupants of public housing are not eligible for the **property tax refund**. Only one taxpayer may claim the refund on behalf of any household living in a particular dwelling.

The implementation of such a refund in the personal tax system can be justified by the **regressivity** of the property tax. By definition, a regressive tax imposes a heavier burden in relation to income on lower-income than on higher-income taxpayers. Since property taxes are the result of a majority decision taken by local governments rather than of individual choices, the tax system tends to compensate for regressivity by a tax credit. This will be discussed in section 2.3.2.2.

2.2.1.6 Indexation

The wave of inflation during the past decade has sparked a lively controversy about the problem of

Table II.12

Indexation factors for personal income tax under the federal and Québec tax systems

	Federal system		Québec system	
Taxation year	Annual rate %	Cumulative indexation factor	Annual rate %	Cumulative indexation factor
1974	6.6	1.066	—	—
1975	10.1	1.174	—	—
1976	11.3	1.307	—	—
1977	8.6	1.419	—	—
1978	7.2	1.521	—	—
1979	9.0	1.658	—	—
1980	8.9	1.806	12.5	1.125
1981	9.8	1.983	7.5	1.209
1982	12.2	2.224	7.5	1.300
1983	6.0	2.357	7.5	1.398
1984	5.0	2.476	5.0	1.467

indexation in the tax system, since not indexing income tax during periods of inflation increases the individual's average tax rate whether or not his real income has gone up. In other words, non-indexation raises an individual's tax burden even though his purchasing power may not have changed, and enables the government to increase its revenues without having to impose tax increases.

Because of the progressivity of marginal tax rates, if the growth in income keeps pace with inflation, taxpayers move up to **taxable income brackets** subject to higher marginal tax rates when the system is not indexed. The ensuing rise in the relative tax burden reduces taxpayer's disposable income. Indexation ensures that the taxpayer's marginal rate will not go up on the increase in income corresponding to the inflation level.

The Carter Commission did not recommend any measure to cancel out the distorting effects of inflation on taxation. The members of the Commission felt it was impossible to compensate completely and equitably for the decline in **real income** caused by inflation, and that compensating for the effects of inflation would alter the stabilizing properties of the tax system. This stand on the part of the Commission aroused little reaction at the time, doubtless because the average annual rate of price increases between 1952 and 1965 was about 1.5%.

In 1974 the federal government indexed personal income tax by introducing adjustment factors for personal exemptions and taxable income brackets on which marginal income tax rates apply. However, in general, the cutoff points for deductions and credits were not indexed. The indexing factor used was calculated on the basis of increases in the consumer price index during the 12 months ending September 30 of the preceding year, with the exception of 1983 and 1984 when it was set at 6% and 5% respectively. This type of adjustment applies to income of all kinds and compensates taxpayers for past inflation, which preserves the automatic stabilizing properties of the tax system following a fluctuation in inflation during the current year.

Because of federal-provincial tax collection agreements, the other provinces modelled their indexing methods along federal lines. The Québec government for its part began to index personal exemptions in 1978, at the time the reform of personal income tax was being implemented. An automatic indexation system like that of the federal government was not adopted however. Instead, indexation rates, applied to personal exemptions only, were established each year at the time of the Budget Speech.

In 1979, income tax was not indexed following the federal-Québec dispute over the retail sales tax, but

Table II.13

Average tax rates without indexation and with partial indexation, by income in 1981 dollars and type of household
Income increase equal to an inflation rate of 31% between 1981 and 1985
(in percentages)

	1981	**1985**		
		Without indexation	**With partial indexation**	**With full indexation**
Single person				
Income: 10 000 $	7.7	10.1	8.1	7.7
20 000 $	14.0	16.1	14.8	14.0
30 000 $	17.7	20.0	18.8	17.7
Childless couple				
Income: 10 000 $	2.2	5.4	2.3	2.2
20 000 $	10.2	13.0	10.9	10.2
30 000 $	14.8	17.4	15.8	14.8

1979's rate was added to the rate for 1980. Table II.12 shows the changes in indexation factors under the Québec and federal tax system since they came into force.

— Objectives of indexation

The main objective of indexing income tax is to ensure that the nominal value of tax payments increases at the same rate as inflation, independent of any change in the taxpayer's purchasing power, making it possible to keep **average tax rates** constant and to preserve the same degree of progressivity after inflation. Thus, the philosophy which governs the indexation theory requires that only real increases in net income and, therefore, in purchasing power, be taxed by income tax.

The indexation of the tax system will protect the taxpayer from automatic increases in taxes which are larger than the growth in his ability to pay. Table II.13 indicates how non-indexation could affect the tax liability of two types of taxpayer — supposing that their incomes kept pace with the inflation rate between 1981 and 1985. Without indexation the average tax rate rises between 2.3 and 3.2 percentage points even if the real income of taxpayers has not increased.

The partial indexation system in effect in Québec's tax system produces smaller increases in tax rates. Moreover, partial indexation corrects the impact of inflation more effectively for taxpayers with low incomes. This emphasizes the importance of exemptions to low and middle-income taxpayers. Thus, partial indexation mitigates the greater part of the pernicious effects of inflation on the ability to pay taxes.

— Investment income

Inflation also creates other distortions with respect to income tax, which makes no distinction between real income and nominal income from personal savings invested in securities or shares, except those shares deposited since the spring of 1983 in an Indexed Securities Investment Plan (ISIP). Interest and dividends are fully taxed when the taxpayer receives them, although the purchasing power of financial assets declines in inflationary times, and a considerable part of such income only compensates for the loss in purchasing power of the assets. Under these circumstances, the investor may very well be faced with higher taxes without any real increase in his investment income.

Were the individual's savings not to produce any interest at a given time, the quantity of goods they would enable him to procure would, in time, decrease as a result of inflation. Savings must produce interest at a rate at least equal to the inflation rate to enable the investor to preserve his purchasing power. Such nominal interest does not represent any real income from the capital invested. Taxes have already been paid on the portion of interest serving only to maintain the real value of income which was not consumed during the preceding period. If the same concept of taxation were applied to earnings and savings, that is, taxing the ability to pay, it would be necessary to tax only the portion of the return on the investment which exceeds inflation. Taxing the portion of interest which serves to maintain the real value of investments must be considered a tax on wealth and not on income.

To mitigate the effects of inflation on interest and dividend income, one of the changes that have been introduced into the tax system is the deduction of the first $1 000 of interest and dividend income. It is obvious, however, that this deduction does not reflect the real extent of the ravages caused by inflation since it brings the same relief to those with great wealth as to those with modest savings, independently of inflation rates. Therefore, with respect to interest and dividend income, the existing tax system increases the incentive for individuals to channel their savings into assets whose returns are exempted from taxation, such as the principal residence.

2.2.2 Consumption taxes

Next to personal income tax, consumption taxes — covering retail sales, fuel, restaurant meals, tobacco, telecommunications and alcoholic beverages, and revenue from the sale of the latter — are the government's second most important source of revenue from individuals. Table II.14 indicates the level of current rates, the bases affected and the main exemptions related to these taxes.

As we saw in Chapter I, consumption, as well as income, can be used to measure taxpayers' ability to pay. However, as in the case of income tax, the present structure of consumption taxes is neither perfectly neutral nor perfectly fair. The various consumption expenditures are not all treated equally by Québec's tax system.

Table II.14

Consumption taxes paid by individuals
Tax structure in effect December 31, 1983

	Nominal rate	Tax base	Main exemptions
Retail sales tax	9%	Purchases of consumer goods except those subject to specific taxes and real estate purchases	Food, clothing, shoes, furniture, refrigerators and stoves, books, prescription medicine, heating oil, natural gas
Fuel tax	30%	Purchase of fuel	No exemption for individuals
Meals and hotels tax	10%	Meals taken in an establishment subject to tax or delivered from such an establishment	Exemption for restaurant meals under 3,25 $ and hotel bills
Tobacco tax	50%	Cigarettes, tobacco, cigars	Tobacco leaves and cigars under 0,05 $
Telecommunications tax	9%	Any telecommunications or rental of line used for telecommunications purposes	None
Taxes on, and revenues from, alcoholic beverages			
— beverages consumed in private homes	9%		
— beverages consumed outside the home	10%		
— SAQ's mark-up equivalent to the dividend paid to the government[1]		Varies according to the type of beverage	

[1] The SAQ collects a mark-up, part of which is used to cover operating expenses, and part of which represents the cash dividend paid to the government. It is the equivalent of a consumption tax.

On the whole, it may be affirmed that consumption is taxed in three different ways in Québec. First, a large proportion of consumer goods is taxed at 9% by the retail sales tax. On the other hand, many other commodities are not taxed at all, either because they benefit from an exemption, like meals costing less than $3.25, furniture, clothing and shoes, or because they are not subject to tax, for instance, personal services. A number of particular goods are subject to specific taxes; the most important are alcoholic beverages, tobacco, fuel and restaurant meals.

Some problems of neutrality obviously arise from the fact that different rates of taxation apply to different categories of consumption. Thus, taxpayers may shift their consumer spending from highly taxed to less taxed goods. This produces a certain loss of economic well-being for consumers generally since the goods chosen as alternatives represent a second preference, slightly less attractive than those they would have chosen in the absence of taxation. The effect of the shift is felt at the production level, stimulating the production of goods that are subject to less tax to the detriment of others.

These analyses of neutrality must be approached with certain reservations in the case of specific taxes, for they are designed to apply the principle of the benefit received rather than of the ability to pay. There are some taxes whose purpose is to recover the costs of certain public services from their users. The gasoline tax covers part of the cost of highways and the taxes on alcoholic beverages and tobacco help finance the additional medical costs occasioned by their consumption.

Such specific taxes do not pose problems of neutrality and resource allocation; on the contrary, they ensure greater efficiency in resource allocation by imputing the cost of certain public services to users who benefit directly from them, or to those whose behaviour or habits cause them to make greater use of public services.

However, certain exemptions play a role contrary to that of specific taxes. Just as specific taxes often aim at discouraging the consumption of certain goods, such as alcohol, exemptions such as those which apply to books and other printed material are designed to encourage their consumption. Other exemptions are designed to stimulate consumption of certain goods so as to increase production in specific soft sectors especially concentrated in Québec. In these cases, non-neutrality is deliberately built in by government.

Even though some consumption taxes are directly related to the benefit received, it must be admitted that several exemptions have a redistributive effect and are aimed at reducing the burden of consumption taxes on low-income taxpayers. Exemptions apply to most essential goods such as food and clothing, and are designed to eliminate taxation from the purchase of essential goods. There is some doubt, however, that the objective is being achieved in every case, since the consumption of luxury items in these categories of goods is also exempt. Furthermore, the consumption of supposedly essential goods is proportionally greater among high-income individuals. Clothing is a case in point. It thus appears that the entire system of exemptions should be analysed in relation to the objectives of equity and neutrality.

2.2.3 Property taxes

In Québec, property taxes are collected mainly by municipalities and to a lesser extent by school boards. Following the reform of municipal taxation, the government expanded the program of grants to school boards so as to transfer to municipalities the school property tax field. The only school property taxes to remain in effect are those which finance the expenditures not covered by the government's education grants. In 1983, Québec taxpayers paid just over $200 million in school property taxes.

For 1983, municipalities collected different sorts of revenue totalling about $4 billion, including $2.3 billion through various property taxes, such as general taxes, special or local apportionment taxes, and service taxes (water, sewers, recreation, etc.).

The base for property taxes in a municipality is the value of land and buildings located within its boundaries and entered on the assessment roll. This value is supposed to reflect the market value of property, or at least a uniform proportion of the market value of all the properties entered on the roll within the municipality.

The amount of property tax payable with respect to taxable real assets is determined by a uniform rate of tax which is levied according to the value of the land or building entered on the roll. In some municipalities, the general property tax is accompanied by one or more other property taxes intended to ensure the financing of certain specific services. Such additional taxes, which may apply to all taxpayers in the municipality, to those in a specific neighbourhood, or only to the users of a particular service, are generally rates levied to finance specific services such as water supply, operation and maintenance of the sewer system, etc.

Since municipal taxation was reformed in 1980, this *White Paper* does not propose to discuss a restructuring of the property tax system. Nonetheless, a comparative analysis of the property tax burden in Québec and Ontario is presented in section 2.3.

2.2.4 Succession duties

After the gradual abandonment of this field of taxation by the federal government and the other provinces, Québec is now the only province to collect succession duties — thereby taxing the assignment of wealth following death. On the international level the situation is different, as can be seen in Table II.2. In fact, most member countries of the OECD impose succession duties and gift taxes. In Canada, only 0.04% of total tax revenues come from succession duties and gift taxes, the lowest percentage among OECD countries, as compared with 1.0% in the U.S. Table II.15 shows that a succession taxed in the United States would generally entail higher succession duties than in Québec. Furthermore, the income tax payable after

Table II.15

Comparison of taxes and duties payable after death
Québec relative to various American states
Tax structure in effect December 31, 1983
(in Canadian dollars)

		Taxes and duties					
		Québec					
		With significant capital gain[1]			**With modest capital gain**[2]		
One heir	**Value of legacy before exemptions and deductions**	**Taxes**	**Succession duties**	**Total**	**Taxes**	**Succession duties**	**Total**
Spouse	50 000			0			0
	200 000			0			0
	1 000 000			0			0
	10 000 000			0			0
Child	50 000			0			0
	200 000	4 000	19 200	23 200	0	20 000	20 000
	1 000 000	75 500	215 105	290 605	30 200	228 242	258 442
	10 000 000	1 510 000	2 822 500	4 332 500	755 000	3 086 750	3 841 750
Other person[2]	50 000	0	6 000	6 000	0	6 000	6 000
	200 000	4 000	37 480	41 480	0	38 400	38 400
	1 000 000	75 500	238 305	313 805	30 200	251 442	281 642
	10 000 000	1 510 000	2 850 500	4 360 500	755 000	3 114 750	3 869 750

1. In Québec, the duties include, in addition to the succession duties payable in Québec, the federal and Québec income taxes payable on the taxable capital gain realized at the taxpayer's death. For the purpose of calculating these taxes on capital gain, it is assumed that:
   - in cases where the heir is the spouse, the transfer is made tax free;
   - in cases where the heir is a child or another person, for tax purposes:
     - a 50 000 $ legacy does not constitute a capital gain;
     - 200 000 $ legacy constitutes a capital gain equivalent to 10% of the value of the legacy in the significant gain hypothesis and to 0% in the modest gain hypothesis while the combined marginal tax rate (federal-provincial) of the deceased person is 40%;
     - a 1 000 000 $ legacy constitutes a capital gain equivalent to 25% of the value of the legacy in the significant gain hypothesis and to 10% in the modest gain hypothesis while the combined marginal tax rate of the deceased person is 60,4%;
     - 10 000 000 $ legacy constitutes a capital gain equivalent to 50% of the value of the legacy in the significant gain hypothesis and to 25% in the modest gain hypothesis while the combined marginal tax rate of the deceased person is 60,4%.

death is usually higher than in Québec even when capital gains are included; these are taxable after death in Québec but not in the United States.

Although revenues from succession duties represent less than $50 million per year in Québec, rarely has a tax aroused so much public controversy. Fifteen years ago, the Carter Commission advocated a more complete taxation of all sorts of income and suggested abolishing succession duties and gift taxes to avoid taxing income twice. However, even after all these years the complete taxation of all forms of revenue still does not exist. Several types of income are still tax free and the system taxes only a small portion of investment income, while preserving several tax deductions. In this respect, then, succession duties may be justified, since they make it possible to tax accumulated assets of which a portion has never been subject to taxation.

Two arguments are heard during the repeated attacks on Québec succession duties. They are criticized, first of all, because they apparently prevent the very wealthy from settling in Québec and from investing capital here, thus hindering our economic development. Succession duties are also attacked because, it is argued, they provoke liquidity problems when firms are assigned to the next generation, thus jeopardizing the company's survival, or at least the family's ability to maintain control.

In answering these arguments, it would be wise to specify that most of the problems posed by liquid assets when firms are assigned to the next generation — which have been alleviated by certain tax provisions such as special deductions granted for shares in a private corporation and for farm property, the 50% credit on duties otherwise payable, as well as the seven-year payment period for these

Table II.15 (continued)

Comparison of taxes and duties payable after death
Québec versus various American states
Tax structure in effect December 31, 1983
(in Canadian dollars)

Taxes and duties						
New York	**Massachussets**	**Maine**	**Florida**	**California**	**Michigan**	**Pennsylvania**
0	0	0	0	0	0	2 850
0	0	5 119	0	0	0	11 850
0	0	54 844	0	0	0	59 850
0	0	639 844	0	0	0	599 850
0	0	610	0	0	750	2 850
4 125	10 875	6 744	0	0	6 250	11 850
255 250	303 875	250 536	235 625	235 625	270 250	266 975
5 589 750	5 756 875	5 245 625	5 245 625	5 245 625	5 245 625	5 245 625
0	0	4 436	0	0	6 000	7 500
4 125	10 875	19 598	0	0	26 750	30 000
255 250	303 875	296 090	235 625	235 625	357 125	357 125
5 589 750	5 756 875	5 245 625	5 245 625	5 245 625	5 959 125	5 779 125

2. Heir who is not a relative of the deceased person.

3. For the American states, the duties also include those evied by the federal government. In addition, the fact that death does not entail taxation of capital gain is taken into account. Taxes and duties have been calculated in American dollars and converted to Canadian dollars at the rate of 1.25 $ Canadian for 1$ American.

duties — could be avoided by proper planning. The problems arising from competitive provincial tax systems appear to be thornier.

2.2.5 Tax evasion

In section 2.2.1 it was noted that several categories of income are exempted from tax, which may result in considerable unfairness and reduce economic efficiency. In addition to exempted income, a substantial amount of income is never declared. The same is true of consumption taxes, for a multitude of sales escape the tax. Obviously, such undeclared income and sales pose the same sorts of problems as exempted ones: they reduce the tax system's fairness and economic efficiency since the State is compelled to tax declared income more heavily in order to finance public expenditures.

By definition, the extent of undeclared income and sales is hardly known. Who has not employed someone or purchased something from someone who demanded payment in cash, and claimed to be unable to provide receipts in acknowledgment of payment? These activities, which are not officially recognized in government accounting or legitimized by an income tax return, have been dubbed the **subterranean economy**, thus underscoring their hidden and indiscernible nature. Some claim that the subterranean economy represents 14% of the GDP in North America, and that the figure is rising. It may even reduce potential personal income tax revenue in the United States by 30%.[7] Others evaluate the subterranean economy at no more than 5% of the GDP.

Various reasons account for the upswing in the subterranean economy. Increased tax rates directly affect it. As taxes on an activity increase, so does the advantage in concealing it. Moreover, as the tax burden increases, the social consensus which led people to comply with the tax system is increasingly undermined; the subterranean economy becomes more and more socially acceptable, thus reinforcing the incentive to participate in it.

Second, the subterranean economy flourishes because of increased regulation of economic activity. Anyone wishing to work for less than the minimum wage, the official rates in the construction industry or any other officially sanctioned minimum wage has little choice but to join the subterranean economy. Although tax evasion may not be the motive for doing so, income or sales resulting from such activities are not generally declared to tax authorities, to minimize the risks of the "illegal" activity's being discovered. The subterranean economy which develops for the sole purpose of avoiding tax leads to reduced efficiency in the general economy, as the activities in question are an alternate choice which is very likely to be less productive. With respect to avoiding inflexible regulations, the development of the subterranean economy often creates additional jobs and increases the economic system's efficiency. This type of subterranean economy partly compensates for the pernicious economic effects of the regulations it circumvents, which does not mean that the regulations are not justified. However, the effect on government revenues is less salutary, as the subterranean economy, regardless of its origins, generates few taxes.

Tax evasion has a number of root causes, and is a phenomenon that has become fairly widespread. One possible solution is undoubtedly the tightening up of control and investigation procedures, although there are disadvantages with respect to efficiency and added cost. Deregulation of the economy must also be pursued. In addition ways of reducing and equalizing tax rates and, as will be shown in Chapter III, **marginal transfer reduction rates** in such a way as to make the tax system fairer and more acceptable to all taxpayers must be sought.

2.2.6 Conclusion

Over the years, Québec has made several choices with respect to how it has occupied its taxation fields. Many of these choices were justified by specific objectives while others were in response to constraints to which it had to adapt. In order to pursue the analysis of Québec's personal tax system, it is important to examine how Québec has utilized the taxation fields under its jurisdiction. Québec's choices in this area are likely to have a significant impact on the distribution of income as well as on the level of taxpayers' disposable income. These issues are dealt with in the next section.

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[7] Peter M. GUTMANN, "The Subterranean Economy Five Years Later", *Across the Board*, February 1983, pp. 25-31, and Pierre FRÉCHETTE, *L'Économie souterraine — examen de la littérature récente*. GRPE Université Laval, 1984.

2.3 An Analysis of the Tax Burden and the Cost of Living

The first part of this section compares the amount of income tax that a number of typical households from Québec and Ontario have to pay at given levels of income. Individuals also contribute every day to the financing of public expenditures through various consumption taxes. They pay property taxes to finance the municipal services they enjoy as well as a portion of school board expenditures which varies from province to province. All these various factors should be taken into account if a comparative analysis of the tax burden of Québec and Ontario households is to be complete. Moreover, an individual's tax situation changes fairly substantially once he reaches 65 years of age.

Once the tax liability of various categories of taxpayers has been estimated, a number of conclusions on the progressivity and the redistributive capacity of Québec's income tax system will be drawn. It is frequently claimed that property and consumption taxes are regressive because they impose a heavier burden on the low and middle-income taxpayer. So, the question of the regressivity of property and consumption taxes under both the Ontario and Québec tax systems is further studied in a separate analysis.

A comparative study of costs of living in various Canadian cities has also been undertaken in order to evaluate how much more, or less, a Québec household would have to pay to maintain the same standard of living if it were relocated in Ontario, Alberta or British Columbia. The purpose of this part is to refocus the debate on the Québec tax burden in a broader perspective which takes into account not only the level of taxation, but all the other factors which affect the cost of living, that is, taxes, food, housing, clothing and other household expenses. The results of this comparative study will provide some answers to the issue of business location and the incentive to live in Québec.

2.3.1 Comparison of the personal tax burden in Québec and Ontario

This section compares the level of income, consumption and property taxes payable in Québec and Ontario. Five typical households representing different family situations are used to illustrate the impact of Québec's tax structure on individuals in Québec; the results are then compared with those obtained by applying Ontario's tax structure to these same typical cases. The typical households chosen to illustrate the results of the study are as follows:

- a single person without dependents;
- a single-parent family with one child under six years of age;
- a childless couple, with only one spouse working outside the home;
- a couple with two children, both under six years of age, with only one spouse working outside the home;
- a couple with two children between 6 and 11, with only one spouse working outside the home;
- a couple with two children between the ages of 6 and 11, with both spouses working outside the home and earning the same income.

2.3.1.1 Methodology

This comparative analysis of the tax structures in Ontario and Québec proceeds in three stages. First, a comparison of the level of personal income tax is presented (Table II.16), followed by a comparison of the levels of consumption and property taxes (Tables II.17 and II.18). Finally, aggregate levels of taxation are compared (Table II.19) in order to obtain the **overall tax burden** of households with similar socioeconomic characteristics and for both tax structures, Québec's and Ontario's. However, before proceeding to the analysis, some of the concepts used should be more accurately defined.

The tax structures used for comparison are those of Québec and Ontario in effect at the end of 1983. Thus, the Québec fuel tax has been considered at the rate of 30%. The amount of individual income tax liability is the total of federal and provincial income taxes payable in each province, taking into account personal exemptions and universal deductions, that is, deductions for employment expenses, unemployment insurance contributions, contributions to the Canada Pension Plan or the Québec Pension Plan and, finally, the lump-sum deduction of $100. Optional deductions such as contributions to a private retirement savings plan or home ownership savings plan have not been taken into consideration, with the exception of the child care expense deduction in the case of a single-parent family or a two-parent family with both spouses on the labour market. Child care expenses for preschoolers are based on a daily rate of $12.00 for 260 working days, for a total of $3 120. For school age children, the cost is $1 560. For income tax purposes, the maximum deduction for child care costs has been assumed.

The health insurance premiums that individuals in Ontario must pay have been included in the amount of personal income tax. The tax liability under both tax structures has been reduced by the amount of transfers to individuals which may be regarded as fiscal measures. Such transfers include the federal and Québec family allowances which replace or reduce the exemption for dependent children, as well as the Québec availability allowance which, at the taxpayer's choice, may replace the deduction for child care expenses. The federal tax credit for children has also been deducted from income tax liability. The amount of consumption and property tax liability varies according to the average consumption pattern of the different types of households. The data relative to the household consumption patterns were derived from the most recent (1978) Statistics Canada study on consumer spending in Québec. These 1978 data have been projected for 1983 according to the evolution of the price index for different goods in Montréal between June 1978 and June 1983. Consumer taxes include the retail sales tax as well as the taxes on telecommunications, fuel, tobacco, meals and alcoholic beverages. The tax on alcoholic beverages includes the dividend paid by the Société des alcools du Québec to the government.

Property taxes include own-source municipal and school revenues which are levied on individual home-owners and tenants. It is assumed that the property tax on rental housing is entirely passed on to the tenant through his rent. Property and sales tax credits in Ontario and the property tax refund in Québec have been deducted from property and personal consumption taxes payable. The aggregate tax burden on households presented in Table II.19 does not include the various federal indirect taxes.

2.3.1.2 Personal income tax

Table II.16 compares personal income tax liability in Ontario and Québec for the six typical households. It also points out the relative and dollar differentials of income tax liability. Some general conclusions can be drawn before proceeding to a detailed analysis of the results. Although the overall burden of personal income tax is heavier in Québec than in Ontario, low-income taxpayers are systematically better off in Québec in all of the categories under study. For example, both a single-parent family with one child and a couple with two children will pay less tax in Québec than in Ontario until the income of the household reaches respectively $24 800 and between $22 600 and $28 200, depending on the age of the children.

Under Québec's tax system, which is more progressive than Ontario's, the tax burden increases more quickly as income increases. For example, the single taxpayer in Québec pays less tax than he would in Ontario until his income reaches $13 600, but at the $20 000 level, he pays almost $500 more than he would in Ontario, a 12% higher tax burden than his Ontario counterpart. The tax burden differential reaches a maximum of 21% at an income of $40 000, and remains fairly constant for the upper income brackets. However, the dollar differential continues to grow as employment income increases. It reaches $3 205 in favour of the single Ontario taxpayer at an income level of $50 000 from employment, and thereafter grows at the rate of $1 000 per $10 000 of employment income. At an income of $75 000, the spread is 5 632 $ and reaches $12 886 at the $150 000 level.

In order to simplify the presentation of results, reference will be made in this section to two types of households, the single-parent family and the couple, as well as to the single taxpayer already mentioned.

The tax burden of a single-parent family in Québec relative to its Ontario counterpart is substantially different from the situation of the taxpayer who is single. The most basic difference relates to the income level at which the income tax payable under the two systems is equal. Whereas the single person in Québec reaches the same tax burden as the single person in Ontario at an income of less than $14 000, the single-parent family in Québec enjoys a tax advantage up to an income level of $25 000. The difference is especially striking for an income of $20 000, on which a single-parent family pays 17% less tax in Québec than Ontario, whereas the single person in Québec pays 12% more than his counterpart in Ontario. Beyond $20 000, the amount of tax liability by a single-parent family in Québec rises quite steeply and, for an income of $30 000, it exceeds the amount payable in Ontario by 8%. This spread gradually increases to 19% for incomes of $150 000 and over. It should be stated, however, that the vast majority of single-parent families earn less than $25 000 and so are better off living in Québec.

The relative fiscal situation of couples in Québec and Ontario varies according to whether or not the couple has children, according to the ages of the

Table II.16

Comparison of net personal income tax liability in Québec and Ontario[1]
1983 taxation year
(in dollars)

		Total net tax				Average tax rates		
Type of household	**Household income**	**Ontario**	**Québec**	**Differential* Québec-Ontario**	**Index of tax burden (Ontario = 100)**	**Ontario (%)**	**Québec (%)**	**Income at which net taxes are equal**
1. Single person without dependents	10 000	1 260	1 061	− 199	84	13	11	13 600
	12 000	1 776	1 683	− 92	95	15	14	
	15 000	2 591	2 683	92	104	17	18	
	17 000	3 137	3 377	239	108	18	20	
	20 000	4 004	4 496	492	112	20	22	
	25 000	5 646	6 583	937	117	23	26	
	30 000	7 471	8 845	1 374	118	25	29	
	40 000	11 339	13 667	2 328	121	28	34	
	50 000	15 815	19 020	3 205	120	32	38	
	60 000	20 291	24 503	4 212	121	34	41	
	75 000	27 797	33 429	5 632	120	37	45	
	100 000	40 479	48 529	8 050	120	40	49	
	150 000	65 843	78 729	12 886	120	44	52	
2. Single-parent family with one child under six	10 000	− 685	− 905	− 220	68	− 7	− 9	24 800
	12 000	− 371	− 623	− 252	32	− 3	− 5	
	15 000	832	191	− 641	23	6	1	
	17 000	1 376	776	− 600	56	8	5	
	20 000	2 171	1 798	− 374	83	11	9	
	25 000	3 592	3 610	19	101	14	14	
	30 000	5 406	5 846	440	108	18	19	
	40 000	9 342	10 664	1 322	114	23	27	
	50 000	13 586	15 769	2 183	116	27	32	
	60 000	18 062	21 196	3 135	117	30	35	
	75 000	25 272	29 840	4 568	118	34	40	
	100 000	37 954	44 940	6 986	118	38	45	
	150 000	63 318	75 140	11 822	119	42	50	
3. Childless couple: one spouse working outside home	10 000	0	21	21	—	—	—	22 700
	12 000	535	348	− 186	65	4	3	
	15 000	1 793	1 238	− 555	69	12	8	
	17 000	2 331	1 888	− 444	81	14	11	
	20 000	3 155	2 929	− 226	93	16	15	
	25 000	4 646	4 859	213	105	19	19	
	30 000	6 372	7 013	641	110	21	23	
	40 000	10 102	11 677	1 575	116	25	29	
	50 000	14 470	16 896	2 426	117	29	34	
	60 000	18 946	22 343	3 397	118	32	37	
	75 000	26 255	31 086	4 830	118	35	41	
	100 000	38 937	46 186	7 248	119	39	46	
	150 000	64 301	76 386	12 084	119	43	51	

* Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

[1] Net personal tax liability is the total of federal and provincial income taxes levied in each of the two provinces, plus health insurance premiums collected from individuals in Ontario (included in Québec personal income tax). Québec income tax is shown net of the Québec availability allowance and Québec family allowances. Federal income tax is shown net of federal credit for children and federal family allowances.

Table II.16 (continued)

Comparison of net personal income tax liability in Québec and Ontario[1]
1983 taxation year
(in dollars)

		Total net tax				Average tax rates		
Type of household	**Household income**	**Ontario**	**Québec**	**Differ-* ential Québec-Ontario**	**Index of tax burden (Ontario = 100)**	**Ontario (%)**	**Québec (%)**	**Income at which net taxes are equal**
4. Couple with two children under six; one spouse working outside home	10 000	– 1 370	– 1 886	– 515	62	– 14	– 19	28 200
	12 000	– 1 370	– 1 672	– 302	78	– 11	– 14	
	15 000	225	– 824	– 1 049	– 366	2	– 5	
	17 000	752	– 182	– 934	– 24	4	– 1	
	20 000	1 576	859	– 717	55	8	4	
	25 000	3 053	2 781	– 272	91	12	11	
	30 000	4 893	5 056	163	103	16	17	
	40 000	9 112	10 210	1 098	112	23	26	
	50 000	13 456	15 431	1 975	115	27	31	
	60 000	17 932	20 878	2 946	116	30	35	
	75 000	25 198	29 591	4 393	117	34	39	
	100 000	37 880	44 691	6 811	118	38	45	
	150 000	63 244	74 891	11 647	118	42	50	
5. Couple with two children between 6 and 11; one spouse working outside the home	10 000	– 1 370	– 1 386	– 15	99	– 14	– 14	22 600
	12 000	– 1 370	– 1 172	198	114	– 11	– 10	
	15 000	225	– 324	– 549	– 144	2	– 2	
	17 000	752	318	– 434	42	4	2	
	20 000	1 576	1 359	– 217	86	8	7	
	25 000	3 053	3 281	228	107	12	13	
	30 000	4 893	5 555	662	114	16	19	
	40 000	9 112	10 710	1 598	118	23	27	
	50 000	13 456	15 931	2 475	118	27	32	
	60 000	17 932	21 378	3 446	119	30	36	
	75 000	25 198	30 091	4 893	119	34	40	
	100 000	37 880	45 191	7 311	119	38	45	
	150 000	63 244	75 391	12 147	119	42	50	
6. Couple with two children between 6 and 11; both spouses working outside home and earning equal incomes	10 000	– 1 370	– 1 433	– 63	95	– 14	– 14	28 700
	12 000	– 1 370	– 1 392	– 21	98	– 11	– 12	
	15 000	– 968	– 1 203	– 235	76	– 6	– 8	
	18 000	– 86	– 617	– 530	– 514	—	– 3	
	20 000	231	– 187	– 418	– 81	1	– 1	
	25 000	1 479	1 276	– 203	86	6	5	
	30 000	2 945	3 033	89	103	10	10	
	40 000	6 201	7 061	860	114	16	18	
	50 000	9 426	11 199	1 773	119	19	22	
	60 000	12 973	15 639	2 666	121	22	26	
	75 000	18 568	22 691	4 123	122	25	30	
	100 000	29 404	35 748	6 344	122	29	36	
	150 000	53 163	64 379	11 216	121	35	43	

* Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

[1] Net personal tax liability is the total of federal and provincial income taxes levied in each of the two provinces, plus health insurance premiums collected from individuals in Ontario (included in Québec personal income tax). Québec income tax is shown net of the Québec availability allowance and Québec family allowances. Federal income tax is shown net of federal credit for children and federal family allowances.

children and whether one or both spouses are working. A childless couple with only one spouse earning employment income enjoys a tax advantage in Québec as long as it earns less than the average industrial wage. A couple will pay 31% less tax in Québec on an employment income of $15 000. However, the spread is reduced to 7% when income reaches $20 000. At higher income levels, the childless couple bears a heavier tax burden in Québec: 10% more at $30 000, 16% to 19% more on incomes of $40 000 and over. The extra burden in dollars is $641 at $30 000, $2 426, $4 830 and $12 084 on incomes of $50 000, $75 000 and $150 000 respectively.

The situation of the same Québec couple in relation to its Ontario counterpart would improve if it had two children under six. The introduction of the Québec availability allowance and of Québec family allowances, which are transfers replacing tax deductions or exemptions, reduces the tax burden of Québec families who receive such transfers. A Québec family with two young children and one spouse working outside the home will pay no income tax on an income of $15 000 and will receive a net transfer of $824, while the same family in Ontario would pay $225 in income tax. The Québec family thus enjoys an advantage of $1 049, which drops to $717 at an income of $20 000. At $28 200, the two families pay the same amount of income tax. At the other end of the income scale, a Québec couple earning $150 000 would have to pay 18% more income tax than its Ontario counterpart, an additional tax burden of $11 647.

However, if this couple had two children between 6 and 11, its ineligibility for the availability allowance would, under Québec's tax system, reduce its transfers by $500, while in Ontario, the situation of such a couple remains the same, whether the children are under 6 or between 6 and 11. A family with two children between 6 and 11 and only one spouse on the labour market earning $15 000 pays no income tax in Québec, and would receive a net transfer of $324. The Ontario family therefore pays the equivalent of $549 more in income tax than the Québec family. At $20 000 of income, this favourable differential shrinks to $217, and disappears altogether when family income reaches $22 600. At $150 000 of income, a Québec couple with two children between 6 and 11 supports a tax burden differential of $12 147, that is, $500 more than the Québec couple with two children under 6.

Under both the Québec and Ontario tax systems, a couple in which both spouses earn the same employment income pays less income tax than a household earning an equal amount of income but with only one spouse working. In Québec, a couple without children, with each spouse earning $25 000, pays $3 730 less income tax than a childless couple with one spouse earning $50 000. This amount does not however take account of the additional costs related to the second spouse's job. Furthermore, the fact that the value of domestic work done by the second spouse when only one is on the labour market is not taxed, is another element that reduces the tax advantage enjoyed by the couple whose income is split between the two spouses.

The Québec couple, with two children between 6 and 11, in which the total income is split equally between both spouses will pay less income tax than a similar couple in Ontario up to an income level of $28 700. For similar households earning higher incomes, there is a significant tax spread in favour of Ontario couples.

The following conclusions may be drawn from this comparative analysis of the income tax liability in Québec and Ontario:

- In all the typical households examined, low-income — and in certain cases middle-income — households generally enjoy an advantage under the Québec tax system, while high-income taxpayers in Québec pay relatively higher taxes. This result stems from Québec's more progressive tax structure. However, the levels of income at which the two structures levy equal taxes show significant variations among the households examined.
- Single taxpayers without dependents represent the category of taxpayers who are the most disadvantaged in relation to their Ontario counterparts. The tax burden of single Québec taxpayers reaches the level of Ontario at an income of $13 600; for an income of $150 000, the differential in favour of the Ontario taxpayer reaches $12 886.
- However, Québec couples with children enjoy a more competitive tax treatment, particularly when both spouses work outside the home. In this case, the break-even point in the income tax liability is reached when the household income is about $28 000 to $29 000, which is close to the average income of Québec households.
- Québec couples with children between 6 and 11 and with one spouse on the labour market are, as a category, in the second worst position relative to similar households in Ontario. Family allowances do not entirely make up for the lack

Table II.17

Comparison between Québec and Ontario Consumption[1] and property taxes after credits 1983 taxation year (in dollars)

		Consumption and property taxes			
Type of household	**Household income**	**Ontario**	**Québec**	**Differential* Québec-Ontario**	**Index of tax burden (Ontario = 100)**
1. Single person without dependents	10 000	649	650	—	100
	12 000	793	758	−35	96
	15 000	1 001	916	−85	92
	17 000	1 119	1 019	−100	91
	20 000	1 283	1 144	−139	89
	25 000	1 474	1 298	−177	88
	30 000	1 633	1 424	−209	87
	40 000	1 883	1 639	−244	87
	50 000	2 032	1 781	−251	88
	60 000	2 159	1 907	−251	88
	75 000	2 491	2 043	−448	82
	100 000	3 087	2 495	−592	81
	150 000	4 251	3 382	−869	80
2. Single-parent family with one child under six	10 000	401	480	78	120
	12 000	537	577	40	107
	15 000	718	741	24	103
	17 000	854	851	−2	100
	20 000	1 054	1 005	−49	95
	25 000	1 359	1 237	−122	91
	30 000	1 542	1 381	−162	90
	40 000	1 820	1 628	−193	89
	50 000	2 053	1 811	−241	88
	60 000	2 197	1 972	−226	90
	75 000	2 548	2 125	−423	83
	100 000	3 205	2 624	−581	82
	150 000	4 495	3 604	−891	80
3. Childless couple; one spouse working outside home	10 000	668	726	58	109
	12 000	869	869	—	100
	15 000	1 082	1 056	−26	98
	17 000	1 232	1 176	−56	95
	20 000	1 464	1 339	−125	91
	25 000	1 843	1 600	−243	87
	30 000	2 113	1 846	−267	87
	40 000	2 470	2 180	−290	88
	50 000	2 756	2 382	−374	86
	60 000	2 968	2 558	−410	86
	75 000	3 530	2 844	−686	81
	100 000	4 418	3 467	−950	78
	150 000	6 166	4 697	−1 469	76

* Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

[1] Consumption taxes include retail sales tax, taxes on fuel, tobacco, restaurant meals, hotel, alcoholic beverages, and telecommunications.

Table II.17 (continued)

Comparison between Québec and Ontario
Consumption[1] and property taxes after credits
1983 taxation year
(in dollars)

		Consumption and property taxes			
Type of household	**Household income**	**Ontario**	**Québec**	**Differential* Québec-Ontario**	**Index of tax burden (Ontario = 100)**
4. Couple with two children under six; one spouse working outside home	10 000	780	885	105	113
	12 000	968	1 043	76	108
	15 000	1 203	1 241	38	103
	17 000	1 376	1 366	−10	99
	20 000	1 621	1 535	−86	95
	25 000	2 002	1 808	−194	90
	30 000	2 319	2 081	−238	90
	40 000	2 722	2 416	−306	89
	50 000	3 077	2 693	−383	88
	60 000	3 400	2 878	−522	85
	75 000	4 060	3 310	−750	82
	100 000	5 107	4 043	−1 064	79
	150 000	7 176	5 493	−1 683	77
5. Couple with two children between 6 and 11; one spouse working outside the home	10 000	780	844	64	108
	12 000	968	1 012	44	105
	15 000	1 203	1 212	9	101
	17 000	1 376	1 327	−50	96
	20 000	1 621	1 511	−110	93
	25 000	2 002	1 787	−215	89
	30 000	2 319	2 059	−260	89
	40 000	2 722	2 401	−321	88
	50 000	3 077	2 652	−424	86
	60 000	3 400	2 876	−523	85
	75 000	4 060	3 272	−788	81
	100 000	5 107	4 006	−1 102	78
	150 000	7 176	5 458	−1 718	76
6. Couple with two children between 6 and 11; both spouses working outside home and earning equal incomes	10 000	445	622	177	140
	12 000	581	757	176	130
	15 000	817	936	119	115
	18 000	1 014	1 111	98	110
	20 000	1 168	1 237	70	106
	25 000	1 562	1 497	−64	96
	30 000	1 830	1 718	−112	94
	40 000	2 308	2 074	−234	90
	50 000	2 708	2 388	−320	88
	60 000	3 109	2 654	−455	85
	75 000	3 898	3 200	−697	82
	100 000	5 065	4 061	−1 004	80
	150 000	7 225	5 601	−1 625	78

* Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

[1] Consumption taxes include retail sales tax, taxes on fuel, tobacco, restaurant meals, hotel, alcoholic beverages, and telecommunications.

of exemptions for children. The level of income at which income tax under Québec's tax structure is equal to income tax under the Ontario tax structure is lower, in their case, than the level of income at which income taxes are equal for couples without children.

— Single-parent families with one child under six are more heavily taxed in Québec when their employment income exceeds $24 800. Since the average income of this type of household is less than $20 000, most single-parent families in Québec pay less income tax than they would in Ontario.

2.3.1.3 Property and consumption taxes

Table II.17 indicates the estimated property and consumption tax liability for the year 1983 by income bracket, and for each of the typical households being studied, under the Ontario and Québec tax systems. The Québec and Ontario property tax credits and the Ontario sales tax credit have been deducted from the total amount of tax payable. The application of these various measures designed to reduce the burden of these taxes for low and middle-income taxpayers is described in section 2.3.2.2.

The amount of these property and consumption taxes paid by each type of household is determined by their average pattern of consumption and, consequently, their income and the number of persons in the household. Thus, for a given level of income, single persons and single-parent families pay less in property and consumption taxes than couples, with or without children. This situation can be explained by the fact that single persons tend to occupy less spacious dwellings and consume less than families with dependents. For instance, a single Quebecer earning $30 000 per year pays an average of $1 400 in property and consumption taxes; a married couple with two children, earning the same income, pays nearly $1 700.

If the property and consumption taxes paid by a Québec household are to be analysed in relation to its Ontario counterpart, the general conclusions to be drawn are the reverse of those noted with respect to personal income tax. Québec households generally pay more consumption taxes when household income is below $16 000. However, in the case of a couple with two children, where both spouses work outside the home, Québec's tax system remains advantageous for an income up to $23 000. Beyond these respective points, property and consumption taxes are generally higher in Ontario. However, the dollar differential in the burden between the two systems is rather small. For a household with two children under six, where one spouse is working and earns $50 000, the Ontario household's additional burden is $383 or $424, depending upon whether the children are under 6 or between 6 and 11; for an income of $150 000, the disparity could reach as much as $1 683 or $1 718 respectively in favour of the Québec household.

The breakdown of these taxes by source for a household with two young children where only one spouse works,[8] set out in Table II.18, indicates that the property and consumption tax for a couple with two young children becomes higher in Ontario as soon as income exceeds $17 000. Property taxes are higher in Ontario for all income brackets. This situation can be explained by the fact that, in Ontario, a considerable portion of school board expenditures are financed through property taxes, while in Québec, virtually the entire cost of financing education has been borne by the Québec government since the implementation of the municipal taxation reform in 1980.

Consumption taxes are more onerous in Québec for low and middle-income taxpayers, while the reverse holds true for high-income taxpayers. This stems from the fact that the Québec system of sales tax and fuel tax imposes a heavier burden on low-income households. This question will be discussed further in the section dealing with the progressivity of the tax system.

2.3.1.4 The overall tax burden

A comparative analysis of a household's tax burden would not be complete without an examination of its financial situation after all the various taxes have been paid. The purpose of this section is to assess the portion of the employment income of the five typical households under study which may be spent directly on consumer goods, or saved, once all taxes have been paid. This analysis takes into account the taxpayer's overall tax burden, that is, personal taxes such as income tax, contributions to the financing of health programs, where applicable, compulsory contributions to unemployment insurance and the Québec and Canada Pension Plans, and the various consumption and property taxes; however, it does not take the effects of the Stock Savings Plan (SSP) into account. All transfers related to income tax, as well as property or sales tax

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[8] This is the most common type of household in Québec.

Table II.18

Comparison between Québec and Ontario
Couple between 30 and 64 with two children under six
Consumption and property taxes
1983 taxation year

	Consumption taxes								Property taxes			
Household income	**Sales and telecommunications**	**Fuel¹**	**Tobacco**	**Restaurant meals**	**Alcoholic beverages**	**Total**	**Credit**	**Net taxes**	**Property taxes**	**Credit**	**Net taxes**	**Total net taxes**
Québec tax structure (dollars)												
10 000	199	142	134	14	62	552	—	552	552	-219	333	885
12 000	234	156	143	18	74	624	—	624	635	-216	419	1 043
15 000	275	172	153	22	88	709	—	709	733	-201	532	1 241
17 000	301	181	158	25	97	762	—	762	794	-190	604	1 366
20 000	336	192	164	28	109	829	—	829	873	-167	706	1 535
25 000	392	209	171	34	129	936	—	936	1 000	-128	872	1 808
30 000	438	222	176	39	145	1 019	—	1 019	1 100	-38	1 062	2 081
40 000	513	241	181	47	171	1 153	—	1 153	1 263	—	1 263	2 416
50 000	583	258	186	55	196	1 278	—	1 278	1 416	—	1 416	2 693
60 000	633	267	186	60	213	1 359	—	1 359	1 519	—	1 519	2 878
75 000	740	297	197	72	250	1 555	—	1 555	1 755	—	1 755	3 310
100 000	920	348	217	91	313	1 889	—	1 889	2 154	—	2 154	4 043
150 000	1 280	446	253	129	439	2 547	—	2 547	2 946	—	2 946	5 493
Ontario tax structure (dollars)												
10 000	177	94	151	14	76	511	-85	426	593	-239	354	780
12 000	221	105	163	17	94	601	-85	516	702	-250	452	968
15 000	249	111	170	20	106	656	-55	601	768	-166	602	1 203
17 000	283	119	177	23	120	721	-46	675	846	-145	702	1 376
20 000	331	128	186	27	140	811	-34	777	953	-110	843	1 621
25 000	408	141	195	34	170	948	-13	934	1 114	-46	1 068	2 002
30 000	476	151	202	40	197	1 066	—	1 066	1 253	—	1 253	2 319
40 000	586	166	209	49	241	1 251	—	1 251	1 471	—	1 471	2 722
50 000	685	179	213	58	279	1 414	—	1 414	1 663	—	1 663	3 077
60 000	775	190	217	65	315	1 562	—	1 562	1 838	—	1 838	3 400
75 000	949	217	235	80	384	1 865	—	1 865	2 195	—	2 195	4 060
100 000	1 227	259	262	104	493	2 346	—	2 346	2 761	—	2 761	5 107
150 000	1 779	342	312	152	712	3 296	—	3 296	3 880	—	3 880	7 176
Index (Ontario = 100)												
10 000	113	151	89	107	82	108	—	130	93	108	94	114
12 000	106	149	88	103	78	104	—	121	90	114	93	108
15 000	110	154	90	110	83	108	—	118	95	79	88	103
17 000	106	153	89	108	81	106	—	113	94	69	86	99
20 000	101	150	88	104	78	102	—	107	92	48	84	95
25 000	96	149	88	101	76	99	—	100	90	78	82	90
30 000	92	147	87	99	73	96	—	96	88	—	85	90
40 000	87	145	87	96	71	92	—	92	86	—	86	89
50 000	85	144	87	95	70	90	—	90	85	—	85	88
60 000	82	141	85	92	68	87	—	87	83	—	83	85
75 000	78	137	84	89	65	83	—	83	80	—	80	82
100 000	75	134	82	87	64	81	—	81	78	—	78	79
150 000	72	131	81	85	62	77	—	77	76	—	76	77

Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario. These results are influenced by the Québec and Ontario income tax structures, since consumption is a function of disposable income. For low-income earners, a higher disposable income in Québec relative to Ontario results in a greater consumption of a given good and hence a higher consumption tax burden. The reverse holds true for high-income earners, since their disposable income is lower under Québec's tax system.

1. The amount of fuel tax reflects the reduction from 40% to 30% which came into effect on November 16, 1983.

Table II.19

Comparison between Québec and Ontario total tax burden¹
1983 taxation year
(in dollars)

		Total tax burden			Tax burden index (Ontario = 100) Excluding SSP	Average rate of total tax burden		
Type of household	**Household income**	**Ontario**	**Québec**	**Québec-* Ontario differential**		**Ontario %**	**Québec Excluding SSP %**	**Income at which tax burden equal**
1. Single person without dependents	10 000	2 286	2 088	−198	91	23	21	14 900
	12 000	3 028	2 901	−128	96	25	24	
	15 000	4 174	4 181	7	100	28	28	
	17 000	4 921	5 060	139	103	29	30	
	20 000	6 048	6 401	353	106	30	32	
	25 000	7 881	8 641	760	110	32	35	
	30 000	9 865	11 030	1 165	112	33	37	
	40 000	13 983	16 067	2 084	115	35	40	
	50 000	18 608	21 561	2 953	116	37	43	
	60 000	23 210	27 171	3 961	117	39	45	
	75 000	31 049	36 233	5 184	117	41	48	
	100 000	44 327	51 785	7 458	117	44	52	
	150 000	70 855	82 872	12 017	117	47	55	
2. Single-parent family with one child under six	10 000	94	−48	−142	−51	1	—	26 400
	12 000	626	414	−212	66	5	3	
	15 000	2 133	1 515	−617	71	14	10	
	17 000	2 895	2 292	−603	79	17	13	
	20 000	3 986	3 564	−422	89	20	18	
	25 000	5 712	5 608	−103	98	23	22	
	30 000	7 709	7 987	278	104	26	27	
	40 000	11 923	13 052	1 129	109	30	33	
	50 000	16 399	18 341	1 942	112	33	37	
	60 000	21 020	23 929	2 909	114	35	40	
	75 000	28 582	32 726	4 145	114	38	44	
	100 000	41 921	48 326	6 405	115	42	48	
	150 000	68 574	79 505	10 931	116	46	53	
3. Childless couple: one spouse working outside home	10 000	1 046	1 124	79	108	10	11	25 500
	12 000	1 863	1 678	−185	90	16	14	
	15 000	3 457	2 877	−580	83	23	19	
	17 000	4 428	3 728	−500	88	25	22	
	20 000	5 380	5 029	−351	93	27	25	
	25 000	7 250	7 220	−30	100	29	29	
	30 000	9 246	9 620	374	104	31	32	
	40 000	13 334	14 619	1 285	110	33	37	
	50 000	17 987	20 039	2 052	111	36	40	
	60 000	22 675	25 662	2 987	113	38	43	
	75 000	30 546	34 691	4 145	114	41	46	
	100 000	44 116	50 414	6 298	114	44	50	
	150 000	71 228	81 843	10 615	115	47	55	

Table II.19 (continued)

Comparison between Québec and Ontario total tax burden[1]
1983 taxation year
(in dollars)

Type of household	Household income	Total tax burden			Tax burden index (Ontario = 100) Excluding SSP	Average rate of total tax burden		Income at which tax burden equal
		Ontario	Québec	Québec-* Ontario differential		Ontario %	Québec Excluding SSP %	
4. Couple with two children under six; one spouse working outside home	10 000	−213	−623	−410	−92	—	—	30 900
	12 000	57	−169	−226	−297	—	—	
	15 000	2 010	1 000	−1 011	50	13	7	
	17 000	2 793	1 849	−944	66	16	11	
	20 000	3 957	3 155	−802	80	20	16	
	25 000	5 816	5 349	−467	92	23	21	
	30 000	7 973	7 897	−76	99	27	26	
	40 000	12 595	13 387	792	106	31	33	
	50 000	17 294	18 885	1 591	109	35	38	
	60 000	22 093	24 517	2 424	111	37	41	
	75 000	30 019	33 662	3 643	112	40	45	
	100 000	43 748	49 495	5 747	113	44	49	
	150 000	71 181	81 145	9 964	114	47	54	
5. Couple with two children between 6 and 11; one spouse working outside the home	10 000	−213	−164	49	123	—	—	24 800
	12 000	57	299	242	525	—	2	
	15 000	2 010	1 471	−540	73	13	10	
	18 000	3 184	2 755	−428	87	18	15	
	20 000	3 957	3 631	−326	92	20	18	
	25 000	5 816	5 829	13	100	23	23	
	30 000	7 973	8 375	402	105	27	28	
	40 000	12 595	13 872	1 277	110	31	35	
	50 000	17 294	19 344	2 050	112	35	39	
	60 000	22 093	25 015	2 922	113	37	42	
	75 000	30 019	34 124	4 105	114	40	45	
	100 000	43 748	49 957	6 209	114	44	50	
	150 000	71 181	81 610	10 429	115	47	54	
6. Couple with two children between 6 and 11; both spouses working outside home and earning equal incomes	10 000	−581	−466	114	115	—	—	30 800
	12 000	−362	−208	155	143	—	—	
	15 000	399	283	−116	71	3	2	
	18 000	1 601	1 168	−433	73	9	6	
	20 000	2 153	1 806	−348	84	11	9	
	25 000	4 001	3 733	−268	93	16	15	
	30 000	5 940	5 917	−23	100	20	20	
	40 000	10 031	10 656	626	106	25	27	
	50 000	13 656	15 109	1 453	111	27	30	
	60 000	17 604	19 815	2 211	113	29	33	
	75 000	23 988	27 413	3 425	114	32	37	
	100 000	35 991	41 331	5 340	115	36	41	
	150 000	61 910	71 501	9 591	115	41	48	

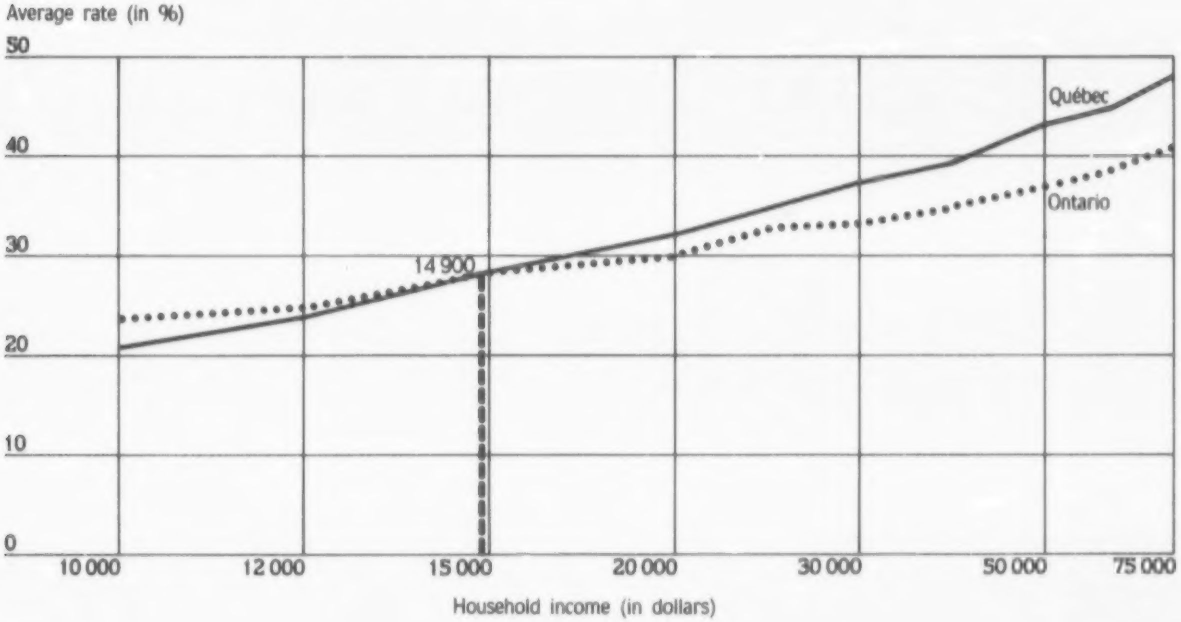
* Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

1. The total tax burden is the sum of federal and provincial income taxes, health insurance premiums in Ontario, property and consumption taxes net of credits, and compulsory contributions (Québec and Canada Pension Plans and unemployment insurance) paid by the household less the following transfers: federal and Québec family allowances, federal child tax credit, and the Québec availability allowance, when it is more advantageous for the household than the deduction for child care expenses.

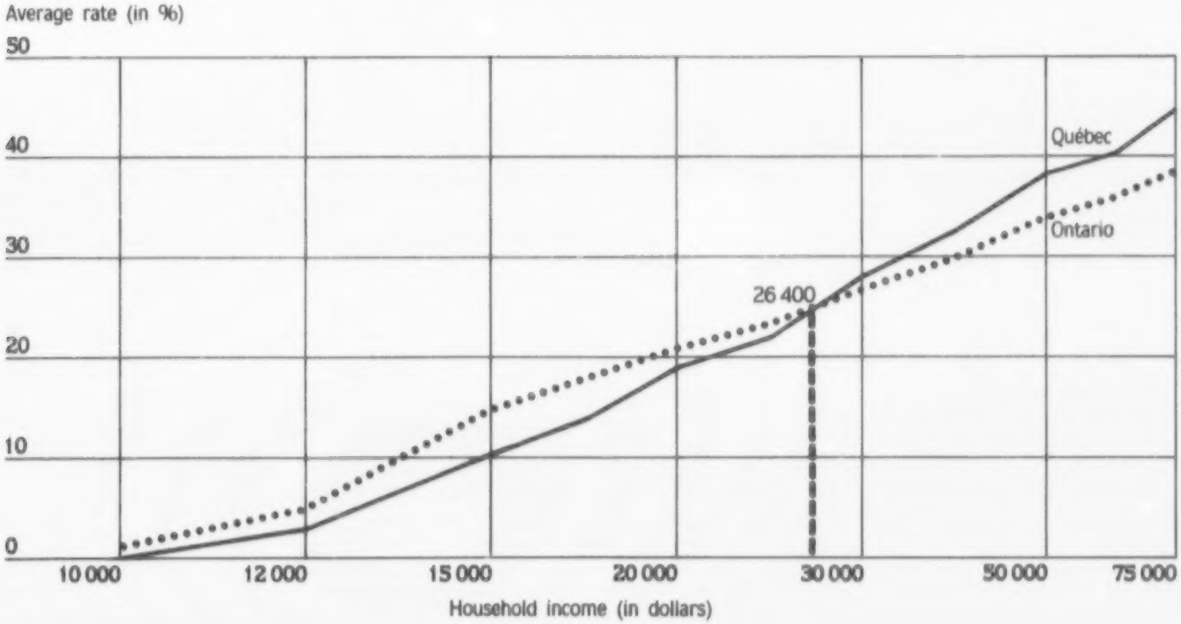
Graph II.2

Overall tax burden as a percentage of household income, by income bracket. Québec and Ontario, 1983

A) Single person without dependents



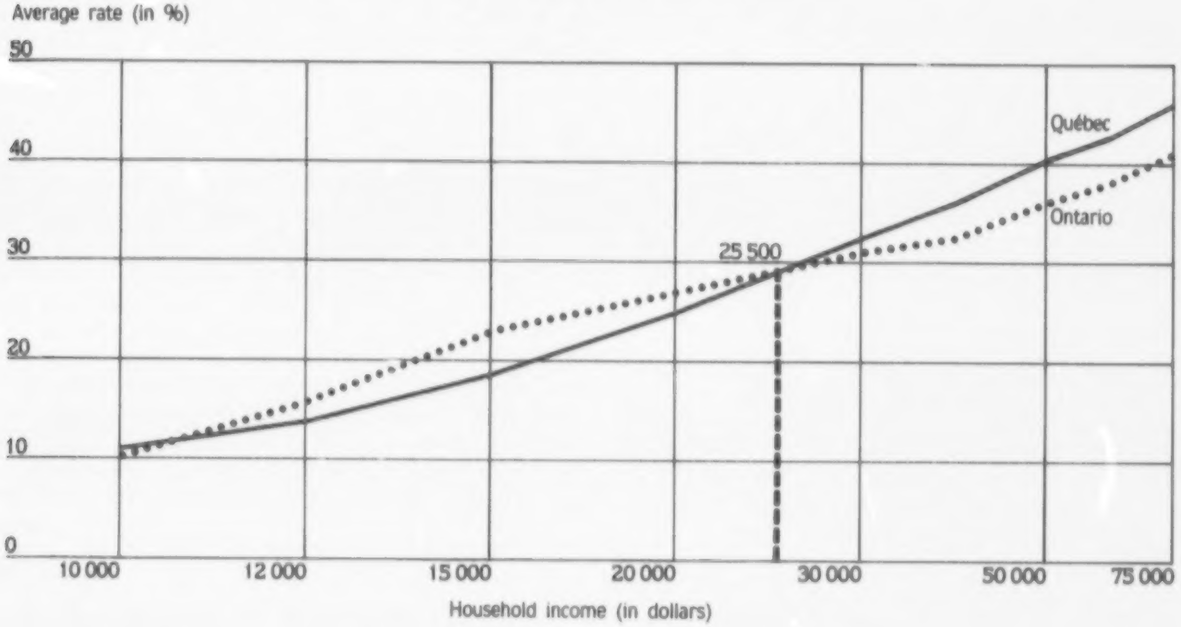
B) Single-parent family with one child under 6



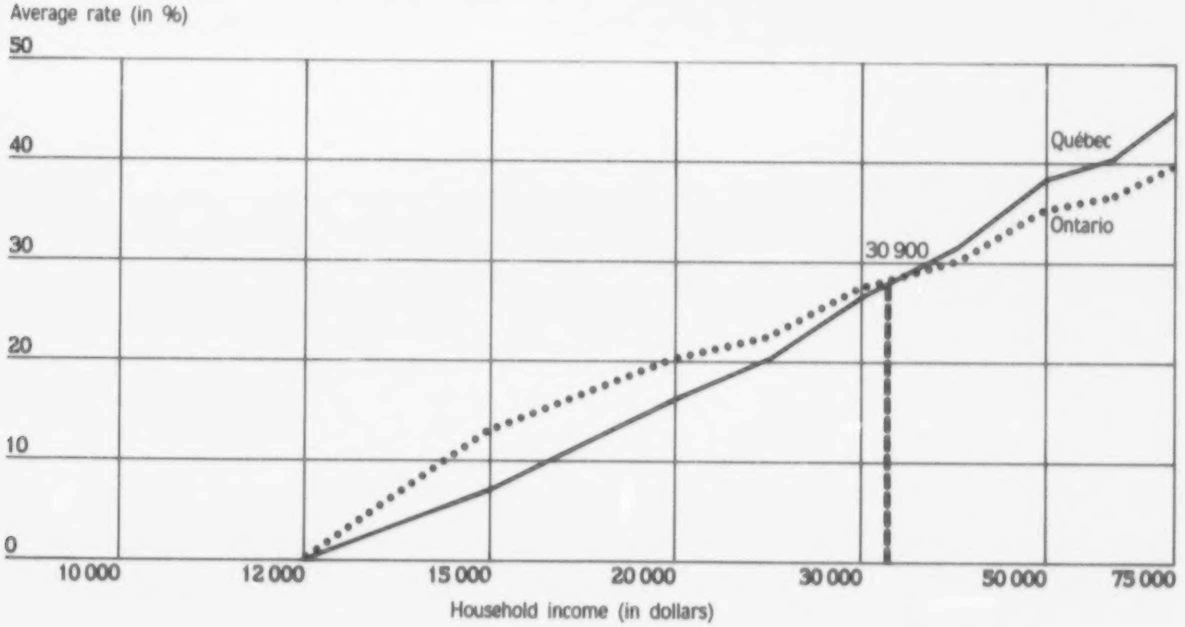
Note: The graphs are drawn on a semi-logarithmic scale.

Graph II.2 (continued)

C) Childless couple, one spouse earning employment income



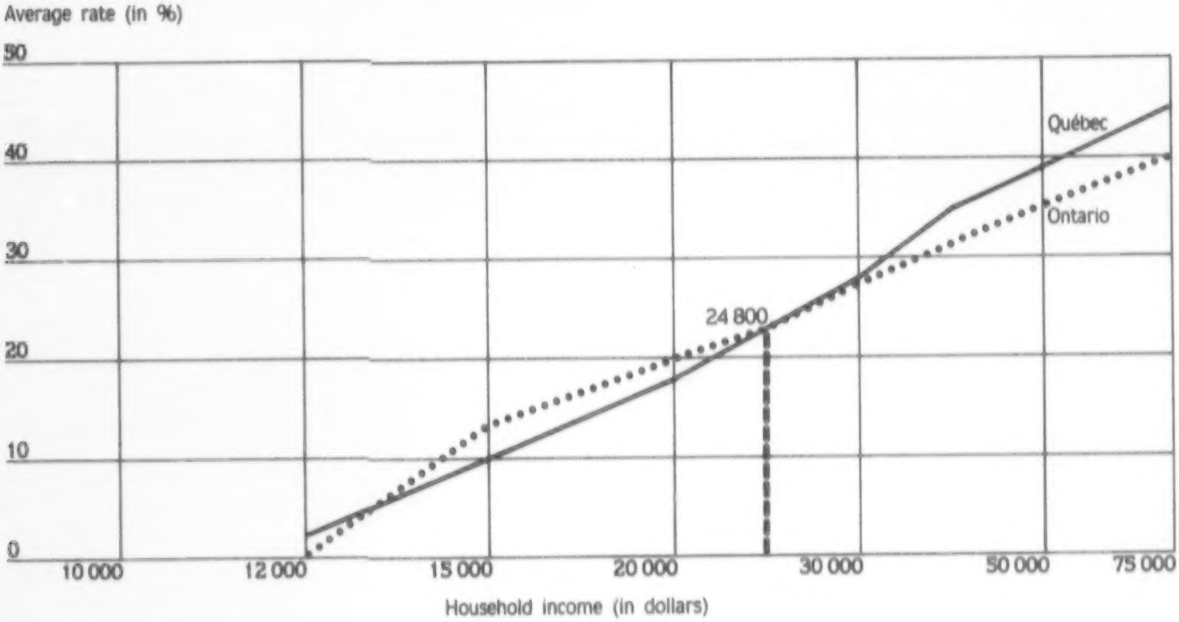
D) Couple with two children under 6, one spouse earning employment income



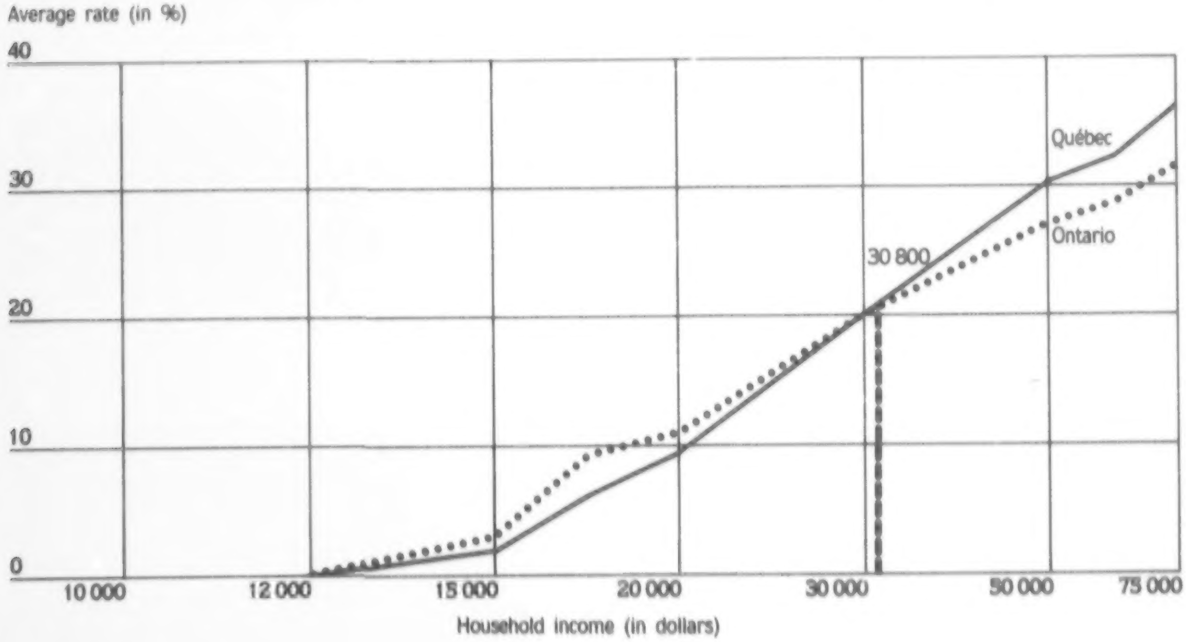
Note: The graphs are drawn on a semi-logarithmic scale.

Graph II.2 (continued)

E) Couple with two children between 6 and 11, one spouse working



F) Couple with two children between 6 and 11, both spouses earning equal incomes



Note: The graphs are drawn on a semi-logarithmic scale.

Source: *Ministère des Finances.*

credits have also been taken into account in calculating the household's total tax burden.

The results obtained in this section are shown in Table II.19 and Graph II.1. Comments on these results will be rather brief, as the total tax burden is largely determined by personal income tax, which has already been examined in detail.

Low-income taxpayers in Québec generally pay less income tax than in Ontario; on the other hand, they pay more property and consumption taxes. The overall tax advantage enjoyed by the low-income Québec taxpayer is thus not as significant as that noted with regard to income tax alone. On the other hand, the high-income taxpayer in Québec pays more income tax than his Ontario counterpart, but less property and consumption taxes. The net result is that the disparity in favour of the Ontario taxpayer with respect to income tax is slightly reduced when property and consumption taxes are taken into account.

The conclusions drawn concerning income tax are not invalidated when all taxes are taken into consideration. Single taxpayers in Québec clearly enjoy fewer advantages than other categories of Québec taxpayers in relation to their Ontario counterparts. For incomes exceeding $14 900, the overall tax burden of the single taxpayer in Québec exceeds that of a single taxpayer in Ontario. With respect to other types of households, the level of income generating an equal overall tax burden is $25 000 for couples with two children between 6 and 11, $26 000 for single-parent families and childless couples, and $31 000 for couples with children under 6, and for couples with children and both spouses on the labour market.

For a gross income of $30 000, a single taxpayer in Québec, pays $1 165 more tax than his Ontario counterpart, while couples with two children have substantially the same tax burden in Québec and Ontario, except for couples with children between 6 and 11 and one spouse on the labour market. With the same gross income, the overall tax burden of single-parent families, childless couples and couples with children between 6 and 11 and one spouse on the labour market is respectively $278, $374 and $402 more in Québec than it is for similar households in Ontario.

A single person earning $150 000 per year will have about $12 000 less to spend or save in Québec than in Ontario. This differential is $10 900 for single-parent families, $10 600 for childless couples, $10 400 for couples with two children between 6 and 11 and one spouse on the labour market and less than $10 000 for married couples with two young children, and couples with children and both spouses on the labour market.

2.3.1.5 Taxation of high-income earners in Québec

— Historical background

The additional tax burden of high-income earners has not always been so high, as shown in Tables II.20 and II.21.

In 1977 (Table II.20), a single Québec taxpayer earning the equivalent of $150 000 today ($94 581 at that time) paid $5 754 more taxes than his Ontario counterpart. Today he pays $12 886 more before the Stock Savings Plan (SSP) and $10 133 with the SSP. Various factors have widened the gap between the Québec and Ontario tax systems. The most important was the personal income tax reform of 1978, which made the tax system more progressive and added $5 110 to the burden of the taxpayer under consideration. The following year, however, Québec introduced its Stock Savings Plan which cut $2 753 from this amount for a taxpayer who invested the average amount invested in the plan by taxpayers in his income bracket.

Between 1978 and 1983, various measures modified in turn the tax burden differential between Québec and Ontario for high-income earners. First, the impact of the partial indexation adopted by Québec increased the Québec-Ontario differential by $1 352 for the same single taxpayer earning $150 000. In 1983, the fact that Québec did not harmonize its marginal rates in line with the reduction presented in the MacEachen budget again increased the gap by a further $2 775. On the other hand, during the 1978 to 1983 period, Ontario also increased its income tax, either by raising its tax rates or by having a basic federal tax which was not completely indexed, as in 1983; this made it possible to reduce the accumulated differential by $2 105 for the case in point.

For incomes of $50 000, $75 000 and $100 000, the same factors came into play but to a lesser extent. At $75 000, the differential increased substantially between 1977 and 1983 ($844 for the couple and $1 210 for the single person); at $100 000 the increase in the differential for 1983 was $1 378 and $1 774 respectively. At $150 000, the increase became really significant.

Table II.20

Evolution of tax burden of high-income taxpayers compared with Ontario income tax
(in dollars)[1]

	50 000 $	75 000 $	100 000 $	150 000 $
Single taxpayer				
1. Québec-Ontario differential in 1977	1 917	2 864	3 800	5 754
2. Impact of the 1978 reform in Québec	431	1 407	2 644	5 110
3. Introduction of the SSP in 1979 (average impact)	-990	-1 558	-2 476	-2 753
• Sub-total	1 358	2 713	3 968	8 111
4. Impact of partial indexation in Québec[2]	941	1 495	1 747	1 352
5. Impact of tax increases in Ontario[3]	-411	-790	-1 183	-2 105
6. Impact of MacEachen budget	327	656	1 042	2 775
7. Québec-Ontario differential in 1983 (including SSP)	2 215	4 074	5 574	10 133
Married taxpayer without children				
1. Québec-Ontario differential in 1977	1 500	2 466	3 440	5 426
2. Impact of the 1978 reform in Québec	2	906	2 074	4 541
3. Introduction of the SSP in 1979 (average impact)	-949	-1 520	-2 430	-2 705
• Sub-total	553	1 852	3 084	7 262
4. Impact of partial indexation in Québec[2]	1 000	1 568	1 941	1 485
5. Impact of tax increases in Ontario[3]	-360	-723	-1 148	-1 947
6. Impact of MacEachen budget	284	613	941	2 579
7. Québec-Ontario differential in 1983 (including SSP)	1 477	3 310	4 818	9 379

1. All data are estimated in 1983 dollars, in order to isolate the impact of partial indexation. Ontario's health insurance premiums are included.
2. This factor gives the tax reduction resulting from indexing the tax tables. It comes from the average tax rate increase for the same real earnings.
3. This factor includes the different impact of federal budgets in Québec and Ontario.

$3 953 for the married taxpayer and $4 379 for the single person.

The evolution in the tax burden differential of high-income earners in Québec is due in part to the changes in marginal rates in Québec and Ontario. In 1981, the differential in maximum marginal rates between the two provinces, which reached 7 percentage points at the time of the 1978 reform, would have dropped to 4.3 percentage points had the MacEachen budget not been tabled — without taking account of the effects of the SSP (Table II.21). Following this budget, Québec, hard hit by the recession, did not reduce its tax rates like the other provinces whose tax rates are set in terms of the "basic federal tax" by virtue of tax collection agreements. Thus, in 1982 the differential in marginal rates between Québec and Ontario reached 10 percentage points. The tax gap is now estimated at 9.7 points.

It can be seen then that the participation of high-income taxpayers in the financing of the State has gone up faster in Québec than in Ontario. The problem of the competitive position of the Québec tax system for these taxpayers has become more acute and calls for measures to reduce their marginal rates.

— The Impact of the Québec Stock Savings Plan (SSP)

Since 1979, a Québec taxpayer has been able to reduce his tax liability by participating in the SSP. This deduction can substantially reduce the tax burden differential between Québec and Ontario taxpayers, particularly for high-income earners. The overall impact obviously depends on the degree of use made of it by Québec taxpayers.

Table II.21

Comparative evolution of maximum marginal rates of personal income tax
Québec — Ontario
1976 to 1983
(in percentage of taxable income)

	1976	1977	1978	1979	1980	1981	1982		1983
							Before MacEachen budget	**After MacEachen budget**	
Québec									
Provincial	28.0	28.0	33.0	33.0	32.5	32.0	32.0	32.0	32.0
Federal	35.7	35.9	35.9	35.9	35.9	35.9	35.9	28.4	28.4
Total	63.7	63.9	68.9	68.9	68.4	67.9	67.9	60.4	60.4
Ontario									
Provincial	14.3	18.9	18.9	18.9	18.9	19.8	20.6	16.3	16.7
Federal	47.0	43.0	43.0	43.0	43.0	43.0	43.0	34.0	34.0
Total	61.3	61.9	61.9	61.9	61.9	62.8	63.6	50.3	50.7
Québec — Ontario differential									
Provincial	13.7	9.1	14.1	14.1	13.6	12.2	11.4	15.7	15.3
Federal	(11.3)	(7.1)	(7.1)	(7.1)	(7.1)	(7.1)	(7.1)	(5.6)	(5.6)
Total	2.4	2.0	7.0	7.0	6.5	5.1	4.3	10.1	9.7

In this respect, it is self-evident that the participation rate is not very high among low-income taxpayers and tends to go up as income rises. In 1981, the rate of use reached 10% only for taxpayers whose income exceeded $50 000. This situation can be explained of course by the fact that the SSP is a far less attractive financial inducement for low and middle-income earners whose marginal tax rates are lower, as well as by a lack of information about the plan and by a lack of knowledge of the securities market among many taxpayers who consider this type of investment too risky. Brokerage fees and financing costs must also be added and may discourage many taxpayers from investing in an SSP.

Table II.22 illustrates the impact, by income bracket, of the SSP on a household's tax burden. The results are as follows: when the average deduction claimed in 1981 by taxpayers earning the same income is attributed to a taxpayer, the tax burden differential between Québec and Ontario is reduced by an average of five percentage points. In absolute terms, the tax reduction for a couple with two children and a single employment income will be about $940 on an income of $50 000, and $2 400 on one of $100 000. An investment of $3 500 in an SSP is necessary in the first case and $8 100 in the second. The results are similar, within a few dollars, for the other typical households. Finally, it is important to note that the contribution levels mentioned in these cases are far below the limits allowed by the plan, that is, 20% of total income up to a maximum of $15 000 less the amounts invested in an RRSP or RHOSP. Maximum use of the SSP could bring about an even more substantial reduction in the tax burden differential between Québec and Ontario for high-income earners.

2.3.1.6 Taxpayers 65 years of age or over

When a taxpayer turns 65 years of age, his taxes and transfers are quite different from those which applied to him before he reached this age. As noted earlier, the tax system grants the taxpayer and his spouse a specific age exemption and does not tax either the first $1 000 of income from a private pension plan or the first $1 000 in interest or dividend income. Furthermore, these deductions, or exemptions, are transferable between spouses if one of the spouses does not earn a high enough income to take advantage of these measures. Also, the taxpayer receives new benefits: the federal

Table II.22

Impact of the Québec Stock Savings Plan (SSP) on tax burden differentials between Ontario and Québec
1983 taxation year
(in dollars)

Type of household	Household income	Tax burden differential Québec-Ontario without SSP	Participation in the SSP		Tax burden differential Québec-Ontario with SSP	Tax burden index (Ontario = 100)	
			Average investment[1]	Impact on tax liability		without SSP	with average SSP
1. Single person without dependents	50 000	2 953	3 500	−990	1 963	116	111
	60 000	3 961	4 400	−1 317	2 644	117	111
	75 000	5 184	5 100	−1 558	3 626	117	112
	100 000	7 458	8 100	−2 476	4 982	117	111
	150 000	12 017	9 000	−2 753	9 263	117	113
2. Single-parent family with one child under six	50 000	1 942	3 500	−932	1 010	112	106
	60 000	2 909	4 400	−1 277	1 632	114	108
	75 000	4 145	5 100	−1 522	2 624	114	109
	100 000	6 405	8 100	−2 463	3 941	115	109
	150 000	10 931	9 000	−2 740	8 191	116	112
3. Childless couple; one spouse working outside the home	50 000	2 052	3 500	−949	1 103	111	106
	60 000	2 987	4 400	−1 302	1 685	113	107
	75 000	4 145	5 100	−1 520	2 625	114	109
	100 000	6 298	8 100	−2 430	3 868	114	109
	150 000	10 615	9 000	−2 705	7 910	115	111
4. Couple with two children under six; one spouse working outside the home	50 000	1 591	3 500	−939	652	109	104
	60 000	2 424	4 400	−1 251	1 173	111	105
	75 000	3 643	5 100	−1 503	2 140	112	107
	100 000	5 747	8 100	−2 403	3 345	113	108
	150 000	9 964	9 000	−2 672	7 292	114	110
5. Couple with two children between 6 and 11; one spouse working outside the home	50 000	2 050	3 500	−938	1 112	112	106
	60 000	2 922	4 400	−1 287	1 635	113	107
	75 000	4 105	5 100	−1 501	2 604	114	109
	100 000	6 209	8 100	−2 400	3 809	114	109
	150 000	10 429	9 000	−2 672	7 757	115	111
6. Couple with two children between 6 and 11; both spouses earning equal incomes	50 000	1 453	3 200	−690	763	111	106
	60 000	2 211	3 800	−922	1 289	113	107
	75 000	3 425	5 400	−1 333	2 092	114	109
	100 000	5 340	7 000	−1 888	3 452	115	110
	150 000	9 591	10 200	−3 029	6 562	115	111

[1] Estimated average investment for 1983, based on the average investment observed for all taxpayers who participated in the SSP in 1981.

Table II.23

Comparison of the zero tax thresholds of taxpayers in the labour force 65 years of age or over and under 65

1983 taxation year
(in dollars)

	Under 65	65 or over	Difference	
			absolute	relative %
Without income from private pension plans or investments				
Single taxpayers	5 487	7 230	1 743	32
Married taxpayers	9 545	14 460	4 915	51
With income from investments and private pension plans[1]				
Single taxpayers	6 487	9 230	2 743	42
Married taxpayers	10 545	16 460	5 915	56

1. The $1 000 deduction from pension income may also be claimed by persons from 60 to 64 years of age, and by others under special circumstances, when the payment is made in the form of a life annuity under a pension plan. If the payment is made under a different private plan and the beneficiary has not reached age 65, it must, in addition, have been made as a result of the death of the spouse.

Table II.24

Average tax rates and income net of the overall tax burden of a taxpayer reaching 65 who worked at the average industrial wage during his lifetime

Married taxpayer
1983 taxation year

	Employment income ($)				
	7 000	11 226	15 000	21 500	30 000
Under 65					
— Taxes ($)				5 676	
— Average tax rate (%)				26%	
— Income net of the overall tax burden					
— in $				15 824	
— in % of earned income				74%	
65 or over					
— Old Age Security Pension ($)	6 132	6 132	6 132	6 132	6 132
— Benefits under the Québec Pension Plan ($)	4 142	4 142	4 142	4 142	4 142
— Total income ($)	17 274	21 500	25 275	31 774	40 274
— Taxes	1 603	3 159	4 670	7 548	11 696
— Average tax rate (%)	9%	15%	18%	24%	29%
— Income net of the overall tax burden					
— in $	15 671	18 341	20 605	24 226	28 578
— in % of earned income	224%	163%	137%	113%	95%

government pays him an Old Age Security Pension and if he has contributed to the Québec Pension Plan, he is eligible for this pension as well.

This section first explains how the tax system affects people turning 65 who remain on the labour market (Table II.23); then a study, taking into account income from pensions and investments, compares the disposable income of elderly persons under the Ontario and the Québec tax system.

The **zero tax threshold** of married taxpayers goes from $9 545 for those under 65, to $14 460 for those 65 years of age or over having no private pension plan. This difference of $4 915 is increased by $1 000 if, within the year, the taxpayer receives $1 000 or more from a private pension fund since he may deduct the first $1 000 of retirement income.

Furthermore, if during his lifetime the married taxpayer has earned an income equivalent to the average industrial wage, he is entitled to an annual pension of $4 142 under the Québec Pension Plan; in addition, each spouse receives the federal Old Age Security Pension of $3 066, that is, $10 274 in public pension income for the household.

If this same taxpayer decided to remain in the labour force after turning 65 and continued to earn $21 500, his income net of the overall tax burden would jump from $15 824 to $24 226 (Table II.24). Despite the rise of more than $10 000 in total income between the ages of 64 and 65, the proportion of the total income paid in taxes would fall from 26% to 24% (Table II.24). If the time spent at work were reduced so as to maintain the same total income of $21 500, taxes paid to the federal and Québec governments would drop from $5 676 to $3 159, a 45% decrease in relation to what he paid at 64. For single persons 65 years of age or over, the benefits are similar to those for couples — though relatively less significant (Table II.25).

The tax benefits granted to taxpayers turning 65 years of age are therefore substantial and, when combined with transfer programs, produce a fairly sizable increase in their disposable income. However, elderly couples who have no private pension plan and whose breadwinner has retired from the

Table II.25

Average tax rates and income net of the overall tax burden of a taxpayer reaching 65 who worked at the average industrial wage during his lifetime
Single taxpayer
1983 taxation year

	Employment income ($)				
	7 000	**12 000**	**14 292**	**21 500**	**30 000**
Under 65					
— Taxes ($)				7 041	
— Average tax rate (%)				33%	
— Income net of overall tax burden					
— in $				14 459	
— in % of earned income				67%	
65 or over					
— Old Age Security Pension ($)	3 066	3 066	3 066	3 066	3 066
— Benefits under the Québec Pension Plan ($)	4 142	4 142	4 142	4 142	4 142
— Total income ($)	14 208	19 208	21 500	28 708	37 208
— Taxes	2 869	4 913	5 905	9 230	13 433
— Average tax rate (%)	20%	26%	28%	32%	36%
— Income net of overall tax burden					
— in $	11 339	14 295	15 595	19 478	23 775
— in % of earned income	162%	119%	109%	91%	79%

work force do not have any income other than the Old Age Security Pension and the Québec Pension Plan.

The tax advantages granted to persons 65 years of age or over which have just been described generally exist in all Canadian provinces. Some provinces have introduced additional measures. For example, in 1980 Ontario introduced a program refunding the first $500 in property taxes to elderly persons or 20% of their rent. When the effects of this program are taken into consideration, the tax difference between Québec and Ontario for persons aged 65 and over is higher than that described earlier for other taxpayers. For example, the additional tax burden for an elderly couple living in Québec will peak at 20% more than their Ontario counterpart between $25 000 and $50 000 income (Table II.26).

2.3.1.7 Conclusions

Section II.1 established that the additional tax burden of individuals in Québec in relation to that of their Ontario counterparts was 14.1% in 1983. Section II.3 has shown that the financing of this additionnal tax burden is borne, in a large proportion, by taxpayers with average and high incomes. This clearly demonstrates the government's preferences for a more redistributive tax system.

2.3.2 The progressivity of Québec's tax system

The previous section presented various typical households comparing tax burdens with respect to income tax, property and consumption taxes, under the Ontario and Québec tax systems. The results of this analysis indicate that low-income workers pay less tax in Québec than in Ontario, while the reverse is true for high-income workers. The increase of taxes following a rise in income is therefore larger in Québec than in Ontario. In other words, Québec's tax system is more progressive than Ontario's.

A tax system is defined as progressive when the average tax rate increases as one moves towards higher income brackets. Inversely, a tax system would be regressive if the average tax rate dimin-

Table II.26

Overall tax burden and net income after taxes
Couples 65 or over whose breadwinner earned, before retirement, an income equivalent to or greater than the average industrial wage
1983 taxation year
(in dollars)

Household income			Overall tax burden[3]			Tax burden index Ontario = 100	Average tax rates		Net income after taxes	
Pension and investments[1]	OASP and QPP[2]	Total	Ontario	Québec	Differential*		Ontario	Québec	Ontario	Québec
10 000	10 274	20 274	2 025	2 177	151	107	10	11	18 249	18 097
12 000	10 274	22 274	2 674	2 942	269	110	12	13	19 600	19 332
14 000	10 274	24 274	3 312	3 725	413	112	14	15	20 962	20 549
16 000	10 274	26 274	3 971	4 545	574	114	15	17	22 303	21 729
18 000	10 274	28 274	4 626	5 404	779	117	16	19	23 648	22 870
20 000	10 274	30 274	5 303	6 278	975	118	18	21	24 971	23 996
25 000	10 274	35 274	7 147	8 597	1 450	120	20	24	28 127	26 677
30 000	10 274	40 274	9 189	11 029	1 840	120	23	27	31 085	29 245
40 000	10 274	50 274	13 448	16 151	2 703	120	27	32	36 826	34 123
50 000	10 274	60 274	18 283	21 739	3 456	119	30	36	41 991	38 535
60 000	10 274	70 274	23 108	27 480	4 372	119	33	39	47 166	42 794
75 000	10 274	85 274	31 135	36 775	5 640	118	37	43	54 139	48 499
150 000	10 274	160 274	71 327	83 620	12 293	117	45	52	88 947	76 654

* Note: Because the figures are rounded off, they may not necessarily equal the difference between Québec and Ontario.

1. Pension income is equal to investment income.
2. Old Age Security Pension is 3 066 $ per spouse and Québec Pension Plan benefits, 4 142 $.
3. Taxes include federal and provincial income taxes, provincial consumption taxes, property taxes less sales tax and property tax credits, as well as the first 500 $ of the property tax refund in Ontario.

ished with an increase of income. It is proportional if the average rate remains constant regardless of income.

Table II.27 illustrates the evolution of average tax rates in relation to the gross household income of a couple with two children under six years of age and only one spouse working outside the home, under the Québec and Ontario tax structures. The observations and conclusions are applicable to taxpayers as a whole in the two provinces, except that tax rates may be different for each case.

First, the highly progressive income tax more than offsets the regressive impact of consumption and property taxes. For this reason, both systems are considered progressive on the whole. In fact, the average rate for Québec taxes goes from 6.6% for a $15 000 income to 15.8% for one of $20 000 and reaches 44.9% for a $75 000 income. This increase in overall tax rates between $20 000 and $75 000 can be broken down as follows: an 8.1% to 40.5% jump in average personal income tax rates combined with a 4.1% to 2.1% fall in average consumption tax rates, while property taxes drop from 3.5% to 2.3%.

In order to compare the relative progressivity or regressivity of the Ontario and Québec tax systems, the fluctuation rate between the average tax rate on a $75 000 income and that on a $20 000 income can be used.

Thus, the progression rate for the whole of Québec's tax system is 184%, compared to 102% for Ontario's. Despite a slightly more regressive con-

Table II.27

Progressivity of taxation in Québec and Ontario
Couple with two children under 6
1983 taxation year
(average rates in percentage of household employment income)

Household employment income ($)	**Québec tax system**				**Ontario tax system**			
	Personal income taxes and contributions[1]	**Consumption taxes**[2]	**Property taxes**[2]	**Total**	**Personal income taxes and contributions**[1]	**Consumption taxes**[2]	**Property taxes**[2]	**Total**
15 000	−1,6	4,7	3,5	6,6	5,4	4,0	4,0	13,4
20 000	8,1	4,1	3,5	15,8	11,7	3,9	4,2	19,8
30 000	19,4	3,4	3,5	26,3	18,9	3,6	4,2	26,6
40 000	27,4	2,9	3,2	33,5	24,7	3,1	3,7	31,5
50 000	32,4	2,6	2,8	37,8	28,4	2,8	3,3	34,6
60 000	36,1	2,3	2,5	40,9	31,2	2,6	3,1	36,8
75 000	40,5	2,1	2,3	44,9	34,6	2,5	2,9	40,0
Degree of progressivity:[3] rate of change of average tax rates between 75 000 $ incomes and 20 000 $ incomes (in percentage)	400	−49	−34	184	196	−39	−31	102

Note: Because the figures are rounded off, they may not necessarily add up to the totals shown.

[1] • Income Taxes: federal and provincial taxes including contribution to health insurance financing in Ontario, less family and availability allowances and federal child tax credit.

• Contributions: contributions to the Québec Pension Plan, to the Canada Pension Plan in Ontario and to the Unemployment Insurance Commission of Canada.

[2] After property and consumption tax credits. These results are influenced by the Québec and Ontario income tax structures, since consumption is a function of disposable income. For low-income earners, a higher disposable income in Québec relative to Ontario results in a greater consumption of a given good and hence a higher consumption tax burden. The reverse holds true for high-income earners since their disposable income is lower under Québec's tax system.

[3] A minus (−) sign indicates the measure is regressive.

sumption tax system in Québec, the progression index is twice as high in Québec as in Ontario for personal income taxes, including contributions, that is, 400% compared to 196%.

The relatively steeper progression of Québec's personal income tax, when compared with Ontario's, is attributable to the strongly regressive nature of per capita health insurance premiums collected in Ontario, to higher personal exemptions in Québec, and to the family allowances and the availability allowance for Québec taxpayers with children. Furthermore, the progression of marginal tax rates is stronger in Québec when one moves through higher taxable income brackets.

2.3.2.1 Property and consumption taxes

Although it is certain that the Québec tax system is very progressive, the utilization of property and consumption taxes has always sparked considerable debate over their fairness for low-income taxpayers. Some claim that property and consumption taxes are clearly regressive because they represent a heavier burden in relation to income for those with the lowest incomes. This observation is also based on the fact that low-income families allocate proportionately more of their income to consumption and housing.

Some others argue that the various consumption taxes are progressive, or at least proportional to income, because low-income households devote relatively more of their income to basic necessities (food, housing, and so forth), which are not generally subject to taxation.

Table II.28 indicates that in Québec, despite the sales tax exemption which applies to essential goods, property and consumption taxes represent a greater burden for low and middle-income taxpayers in relation to their income for each of the typical households represented. For example, a single taxpayer earning $10 000 pays the equivalent of 6.5% of his income in property and consumption taxes net of credits, compared with 3.6% paid by one earning $50 000. For this particular case the relative tax burden of the high-income taxpayer is 45% less than that of the low-income one. The degree of regressivity noted in the cases of a childless couple and a couple with two children under 6 is quite similar, which explains why only these three typical households were studied.

Property and consumption taxes under the Ontario tax system are also regressive, but to a lesser degree than in Québec, because relative to their income, high-income families pay more property and consumption taxes in Ontario than in Québec.

When the total amount is broken down among sales taxes and the other consumption taxes, they all prove to be regressive, but to a lesser extent in Ontario than in Québec. However, the degree of regressivity with respect to sales tax is considerably higher in Québec. A family with one spouse on the labour market and two children under 6 spends 50% less of its income to pay sales taxes when its income is $75 000 than when it is $10 000. In Ontario, this differential, with respect to the same taxpayers, is only 28%.

2.3.2.2 Reducing the regressivity of taxation

Selective sales tax exemptions on essential goods in Québec have made it possible not only to avoid taxing essential goods but also to stimulate consumption to the benefit of certain industrial sectors of the Québec economy in particular. Thus the objective of not taxing essential consumption of such goods is reached for both low-income and high-income taxpayers. On the other hand, they have even eliminated the tax on excessive consumption of the same goods by the wealthy. For example, a household with an income between $50 000 and $100 000 allocated the same proportion of its income to clothing as the average for all Québec households, i.e. 6.4%. This figure was a little higher for households earning between $10 000 and $20 000 (6.6%). The average household allocated 1.4% of its income to furniture, while those with high incomes spent a little more (1.5%) and those with low ones a little less (1.2%). Consumption of these goods is almost proportional to income, whereas for other goods subject to consumption taxes consumption as a proportion of income is usually lower for persons with the highest incomes.

These examples point up the problem of the efficiency of programs to reduce the regressivity of property and consumption taxes.

Governments have attempted to adopt measures which could attenuate the regressivity of property and consumption taxes. At present, there are a number of programs designed to refund part of the property and consumption taxes paid by low-income families, in order to reduce their tax burden.

In Québec, the property tax refund was implemented in 1979 with a view to reducing the regressivity

Table II.28

Comparison of the regressivity of property and consumption taxes before and after tax credits, under the Québec and Ontario systems
1983 taxation year
(in percentage of household employment income)

Type of household	**Québec tax structure**		**Ontario tax structure**	
	Before Credit	**After Credit**	**Before Credit**	**After Credit**
1. Single person without dependents				
Household employment income ($)				
10 000	7,48	6,50	8,09	6,49
15 000	6,43	6,11	7,17	6,67
20 000	5,72	5,72	6,42	6,42
30 000	4,75	4,75	5,44	5,44
40 000	4,10	4,10	4,71	4,71
50 000	3,56	3,56	4,06	4,06
Degree of progressivity[1]	−52%	−45%	−50%	−37%
2. Childless couple; one spouse working outside the home				
Household employment income ($)				
10 000	9,32	7,26	9,77	6,68
15 000	8,27	7,04	8,49	7,22
20 000	7,45	6,70	7,88	7,32
30 000	6,28	6,15	7,04	7,04
40 000	5,45	5,45	6,18	6,18
50 000	4,76	4,76	5,51	5,51
Degree of progressivity[1]	−49%	−34%	−44%	−18%
3. Couple with two children under six; one spouse working outside the home				
Household employment income ($)				
10 000	11,04	8,85	11,04	7,80
15 000	9,61	8,27	9,49	8,02
20 000	8,51	7,68	8,82	8,11
30 000	7,06	6,94	7,73	7,73
40 000	6,04	6,04	6,81	6,81
50 000	5,39	5,39	6,15	6,15
Degree of progressivity[1]	−51%	−39%	−44%	−21%

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[1] The degree of progressivity measures the percentage reduction of the average tax rate in proportion to income from the highest income bracket (50 000 $) to the lowest income bracket (10 000 $). The more negative the degree of progressivity is, the more regressive the tax structure.

of property taxes. Under this program, low and middle-income taxpayers may obtain a refund of up to 40% of the property taxes paid, or attributed, in the case of tenants, during the tax year, depending on total household income. Currently, households with a gross income under $20 000 benefit from that measure. In 1981, one third of Québec households received property tax refunds totalling $95 million. On the average, eligible households received $134, or about 16% of their property tax burden.

The Ontario government administers a program of credits which is intended to cover property and sales taxes. The value of the property tax credit is determined by the property taxes — and for tenants, the rent — paid, and by the highest taxable income of the household. The value of the sales tax credit is determined by a percentage of personal exemptions and by the household's highest taxable income. These tax credits are claimed by the taxpayer on his income tax return.

Table II.28 illustrates the effects of property and sales tax credits on the tax burden of certain types of taxpayers in Québec and Ontario. For example, a childless Québec couple with a single annual income of $10 000 pays the equivalent of 9.3% of its income in property and consumption taxes. This burden drops to 7.3% of gross household income if the property tax credit is taken into account. The property tax credit thus actually achieves its goal of reducing the regressivity of this tax, at a relatively low cost because of the selective nature of the approach.

This type of mechanism appears to be effective and relatively inexpensive. Extended to the sales tax and redefined in terms of the objectives to be reached, it could prove an efficient method of reducing the regressivity of consumption and property taxes. A broader utilization of such tax credits would enable the government to finance its requirements to a greater extent by consumption taxes rather than by taxes on production, such as income tax, which have a negative impact on the incentive to work and live in Québec.

Before we conclude this section, it must be emphasized that the tax burden is not the only crucial factor affecting the decision to live in Québec. The overall cost of living, including housing, food, clothing, and so forth, must also be taken into consideration. This question of the overall cost of living in Québec will be studied in the following section.

2.3.3 Impact of the tax burden and cost of living on the incentive to live in Québec

We have just compared the tax burden of Québec households, with that of their Ontario counterparts with similar socioeconomic profiles. It must, how-

Table II.29

Comparison of the regressivity of consumption taxes, before credits, under the Québec and Ontario tax structures
For a family with two children under six
1983 taxation year
(in percentage of employment income)

Household employment income ($)	**Québec tax structure**		**Ontario tax structure**	
	Sales tax[1]	**Other taxes**	**Sales tax**[1]	**Other taxes**
10 000	1,99	3,53	1,77	3,34
15 000	1,83	2,89	1,66	2,71
20 000	1,68	2,47	1,66	2,40
30 000	1,46	1,94	1,59	1,97
40 000	1,28	1,60	1,47	1,66
50 000	1,17	1,39	1,37	1,46
60 000	1,06	1,21	1,29	1,31
75 000	0,99	1,09	1,27	1,22
Degree of progressivity[2]	−50%	−69%	−28%	−63%

1. Includes retail sales tax and tax on telecommunications.

2. The degree of progressivity measures the variation in the average tax rates as a proportion of income between the highest income bracket, $75 000, and the lowest, $10 000. The more negative the degree of progressivity, the more regressive is the tax system.

ever, be recognized that for accurately evaluating the incentive to live in Québec as well as the costs and benefits of a transfer, it is necessary to consider not only the level of various taxes but also all the consumption expenditures which ultimately determine the cost of living. For that purpose, an independent agency, which specializes in comparative studies of the cost of living and the assessment of the cost of transferring companies, carried out a study for the Québec government.[9] The methodology and results of the study are analysed in the following pages.

2.3.3.1 Objectives of the comparative study

The objectives of the sudy were essentially to establish the overall cost of living for six typical households in the following cities, in September 1983: Montréal, Ottawa, Toronto, Edmonton and Vancouver.

The approach used makes it possible to ascertain the differences in costs between the cities in question, which would be entailed in transferring each household studied.

2.3.3.2 Methodology

The typical households studied represent a range of annual incomes varying between $10 000 and $75 000, to reflect the income scale of the large majority of Québec households.[10] The typical households considered are as follows:

Household 1:
A single person living alone in an apartment and earning $10 000 per year;

Household 2:
A married couple with a three-year-old child living in an apartment and earning $20 000 per year; only one spouse works outside the home;

Household 3:
A married couple which owns a single-family dwelling, and earns $30 000 per year. There are two children, aged five and eight; the spouses earn $20 000 and $10 000 per year, respectively;

Household 4:
A married couple which owns its own home and earns $30 000 per year. There are two children, aged five and eight; only one spouse works outside the home;

Household 5:
A married couple which owns its own home and earns $50 000 per year. There are two children, aged 16 and 18; only one spouse works outside the home;

Household 6:
A married couple which owns its own home and earns $75 000 per year. There are two children, aged 16 and 18. Only one spouse works outside the home.

— Cost-of-living components

For each of the six typical households, a list of goods and services was drawn up, varying in terms of quantity and quality according to household income, social environment, civil status of the member(s) of the household, number and age of children, type of dwelling, means of transportation used, and so forth. Table II.30 gives a more detailed description of the lifestyle of each of the households studied.

While the shopping list of the families with different incomes varies in quantity and quality, purchases remained constant when households with the same incomes in the different cities were compared. For a given income, variations in the cost of living only reflect differences in prices which were noted in these cities. The purpose of this analysis is to compare the cost of the same commodities in different cities, without necessarily taking into account local consumer habits.

The consumer goods bill employed in this study takes into account the main factors in the cost of living, including taxes, housing, food, transportation, clothing, household supplies and miscellaneous expenses. Overall, it includes slightly more than 150 items.

Taxes and housing are the main factors in determining the cost of living in Canada. The importance of both elements in family budgets is such that it is essential to clearly define the basic assumptions underlying estimates made with respect to them in the present comparative study.

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[9] *Comparative Living Costs*, study prepared for the Government of Québec by the Compensation Research Centre, an agency of The Conference Board of Canada, September 1983.

[10] The case of a household earning $150 000 is not discussed, because the Compensation Research Centre sample was not considered representative in this regard.

Table II.30

Comparative study of the cost of living Of the typical households analysed

Description of household	Number and age of children	Type of dwelling to be rented or bought	Means of transportation owned and used
Household 1: single person earning 10 000 $ per year.	None.	Lives in a one-bedroom apartment in a low-income neighbourhood near the city centre. Has 800 sq. ft. of living space. Monthly rent includes electricity, heat and rental of a fridge and electric stove.	Does not have a car and uses public transport to go to work.
Household 2: married couple earning 20 000 $ per year; one spouse working.	One child aged three.	Lives in a two-bedroom apartment in a middle-income neighbourhood near the city centre. Has 900 sq. ft. of living space. Monthly rent includes the same services as for Household 1.	Owns a four-year-old North American compact, but uses public transport to go to work.
Household 3: married couple earning 30 000 $ per year; both spouses work and earn 10 000 $ and 20 000 $ respectively.	Two children aged five and eight.	Lives in a three-bedroom bungalow in a middle-income neighbourhood. Average lot is fully serviced. House has 1 200 sq. ft. of living space.	Owns a two-year-old North American compact. Both spouses use public transport to go to work.
Household 4: married couple earning 30 000 $ per year; only one spouse works.	Two children aged five and eight.	Same situation as Household 3.	Same situation as Household 3.
Household 5: married couple earning 50 000 $ per year; only one spouse works.	Two children aged 16 and 18.	Lives in a two-storey, three-bedroom, single-family dwelling in a upper-middle class neighbourhood. Above average, fully serviced lot. The house has 1 800 sq. ft. of living space.	Owns a North American intermediate of the current model year, which is used to drive to work.
Household 6: married couple earning 75 000 $ per year; one spouse works.	two children aged 16 and 18.	Lives in a two-storey, four-bedroom, single-family dwelling in a high-income neighbourhood. Big, fully serviced lot. The house has 2 000 sq. ft. or living space.	Owns a luxury North American car of the current model year, which is used to drive to work.

Source: *Compensation Research Centre, The Conference Board of Canada.*

— Assumptions regarding the cost of housing and taxes

As the purpose of this study is to determine differences in the cost of living in various Canadian cities, it was postulated that households moved to another city in September 1983 and maintained exactly the same standard of living. Thus, where the families in question owned their homes, this implied selling them in order to buy another one in the same category in the city to which they moved. Average prices for typical homes in each of the cities in September 1983 were established on the basis of a recent analysis of real estate transactions.

Monthly mortgage payments vary according to the capital borrowed, the term of the mortgage, and the interest rate. To estimate such mortgage payments, it was supposed that the owner leaving Montréal had an equity equivalent to 50% of the value of his house in September 1983, and that these funds were used to make a cash down payment on his new home. It was also supposed that families living in other Canadian cities with similar incomes would have the same amount of cash to devote to the purchase of a new home when they moved. In this study, a constant net value in dollars was used for each type of residence.[11]

For example, the value of the residence of Household 3 living in Montréal was set at $56 000 in September 1983. Consequently, each family representing this household would have $28 000 in cash to purchase a new house when the family was transferred. It was also supposed that the balance of the purchase price of the house was financed through a 25-year mortgage loan at 13.75%, the average rate noted in September 1983.

Taxes payable depend not only on household income, but also on the civil status of the persons in question, the number of children and their age, and the optional deductions claimed by the taxpayer, such as contributions to a registered retirement savings plan. However, it should be noted that the health care insurance premium collected by the Ontario, Alberta and British Columbia governments are considered in this study to be a personal tax borne entirely by the taxpayer, as provided for in the tax legislation in force in these provinces. The amount of **transfers related to income tax** and paid to families by various levels of government, and the various provincial programs of property and sales tax refunds where applicable, has been deducted from the taxes and social charges payable. The transfers in question are the federal and Québec family allowances, the Québec availability allowance, and the federal child tax credit. Data respecting the tax burden of the households considered in this study were provided by the ministère des Finances du Québec while those concerning housing and consumption costs were taken from the Compensation Research Centre study.

2.3.3.3 Results of the comparative study

Two main conclusions may be drawn from an analysis of the results of the comparative study of the cost of living in various Canadian cities:

- The cost of general consumer goods, such as food, clothing, transportation, household products and personal services, does not vary much from one city to another (generally less than 5% between the cities with the highest and the lowest cost of living), and have relatively little impact on differences in the cost of living.
- Taxes, on the one hand, and the cost of housing, on the other, fluctuate enormously from one city to another; as a result, the combined cost of these elements generally determines how expensive it is to live in one city compared with another.

Table II.31 shows a cost of living index that makes it possible to compare the cost of living in Montréal and in the other cities studied. Together with diagrams II.1 to II.6 the table highlights the effect of "taxes and social contributions" and "housing costs" on the differentials observed. The results will be discussed briefly for each type of household.

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[11] Certain comparative studies of the cost of living assume a net value representing a constant percentage of the price of the residence. For example, had the assumption of a net value representing 50% of the value of the residence been used, the net value of the residence of Household 3 living in Montréal would still be $28 000. The net value of a comparable residence would have been $57 000 in Vancouver. The latter assumption was rejected because it does not present the real situation faced by taxpayers moving to cities where house prices are relatively high, and because it does not permit comparison of taxpayers with similar wealth.

Table II.31

Difference in the cost of living in Montréal compared with various Canadian cities
September 1983
(in dollars)

	Household 1	**Household 2**	**Household 3**	**Household 4**	**Household 5**		**Household 6**	
	10 000	**20 000**	**30 000**	**30 000**	**50 000**		**75 000**	
Income					**Without SSP**	**With SSP[1]**	**Without SSP**	**With SSP[1]**
Montréal/Ottawa								
• Personal income tax	−193	−604	−61	161	1 842	903	4 185	2 682
• Expenses including taxes								
— housing	−230	−410	−4 940	−4 940	−4 055	−4 055	−4 650	−4 650
— other	−40	150	−70	90	530	530	770	770
— subtotal	−270	−260	−5 010	−4 850	−3 525	−3 525	−3 880	−3 880
• Cost of living	−463	−864	−5 071	−4 689	−1 683	−2 622	305	−1 179
• Cost of living index (Montréal = 100)	105	105	118	117	103	105	100	102
Montréal/Toronto								
• Personal income tax	−197	−610	−56	156	1 842	903	4 185	2 682
• Expenses including taxes								
— housing	−30	−150	−5 752	−5 752	−5 441	−5 441	−6 238	−6 238
— other	−230	−150	−530	−250	−90	−90	—	—
— subtotal	−260	−300	−6 282	−6 002	−5 531	−5 531	−6 238	−6 238
• Cost of living	−457	−910	−6 338	−5 846	−3 689	−4 628	−2 053	−3 556
• Cost of living index (Montréal = 100)	105	105	123	121	107	109	103	105
Montréal/Edmonton								
• Personal income tax	114	−178	553	755	3 125	2 186	6 281	4 778
• Expenses including taxes								
— housing	−270	−510	−2 902	−2 903	−2 441	−2 441	−3 720	−3 720
— other	−200	80	−80	90	640	640	920	920
— subtotal	−470	−430	−2 982	−2 813	−1 801	−1 801	−2 800	−2 800
• Cost of living	−356	−608	−2 429	−2 058	1 324	385	3 481	1 978
• Cost of living index (Montréal = 100)	104	103	109	107	97	99	95	97
Montréal/Vancouver								
• Personal income tax	−65	−302	650	977	2 931	1 992	5 329	3 826
• Expenses including taxes								
— housing	−460	−760	−7 264	−7 264	−6 694	−6 694	−7 734	−7 734
— other	−320	−650	−880	−730	−930	−930	−1 040	−1 040
— subtotal	−780	−1 410	−8 144	−7 994	−7 624	−7 624	−8 774	−8 774
• Cost of living	−845	−1 712	−7 494	−7 017	−4 693	−5 632	−3 445	−4 948
• Cost of living index (Montréal = 100)	109	109	127	125	109	111	105	107

[1] The amount invested in a Stock Savings Plan (SSP) was set at 3 500 $ and 5 100 $ respectively for households 5 and 6, that is the average amount invested by taxpayers in these income brackets who took advantage of the SSP in 1981.

Note: A minus (−) sign indicates a cost of living which is lower in Montréal relative to the city under consideration.
Source: *Compensation Research Centre, The Conference Board of Canada and the ministère des Finances.*

Diagram II.1

Household n° 1: Single person earning 10 000 $
Cost of living in September 1983

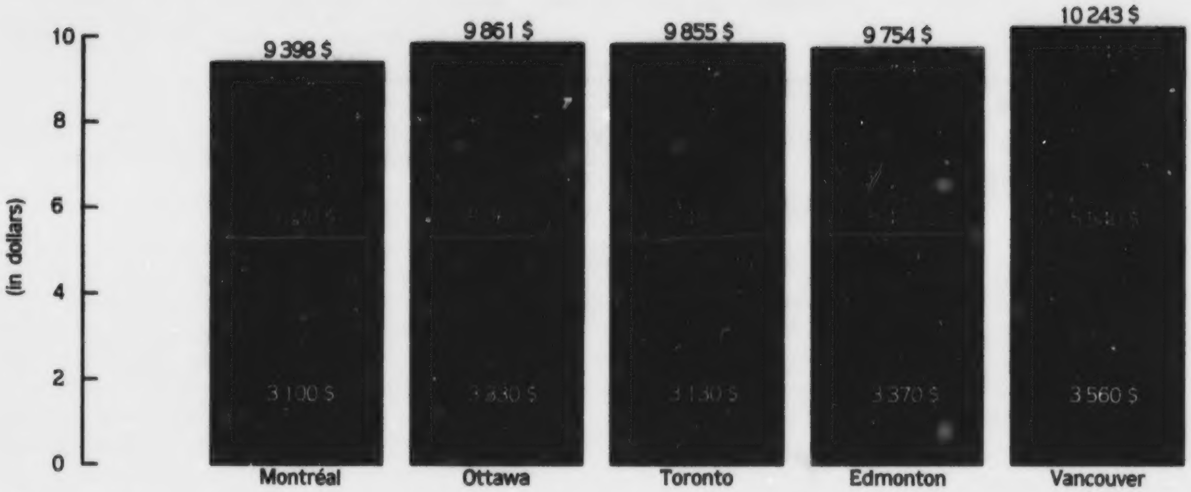
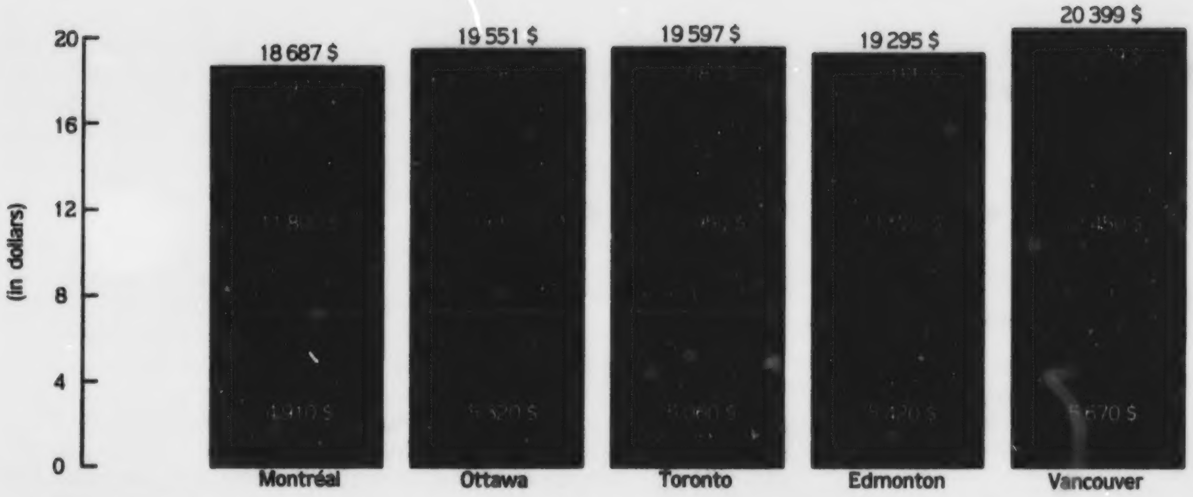
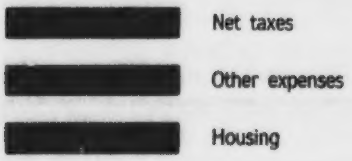


Diagram II.2

Household n° 2: Couple earning 20 000 $
one spouse working
Cost of living in September 1983





Sources: — *Compensation Research Centre, Conference Board of Canada.*
— *Ministère des Finances.*

Diagram II.3

Household n° 3: Couple earning 30 000 $
one spouse working
Cost of living in September 1983

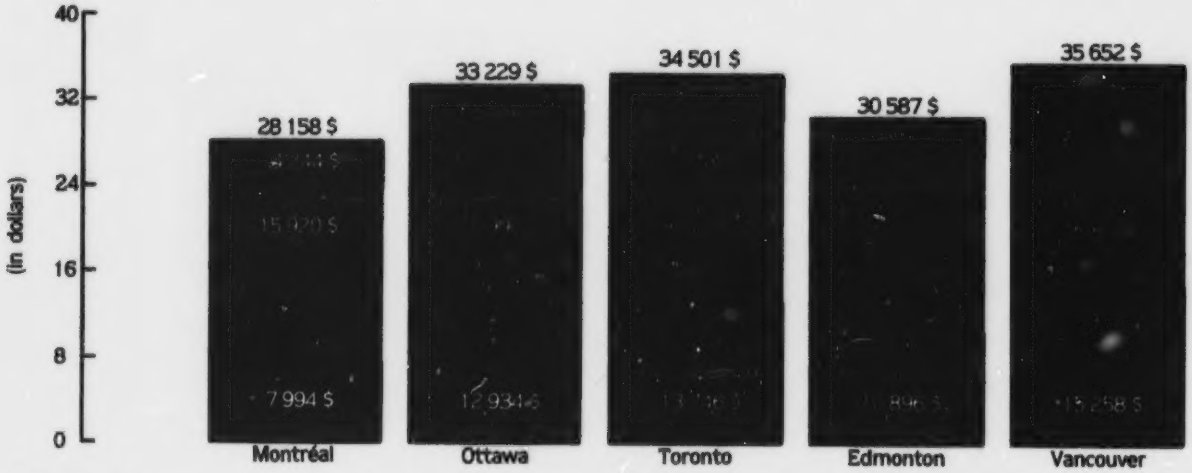
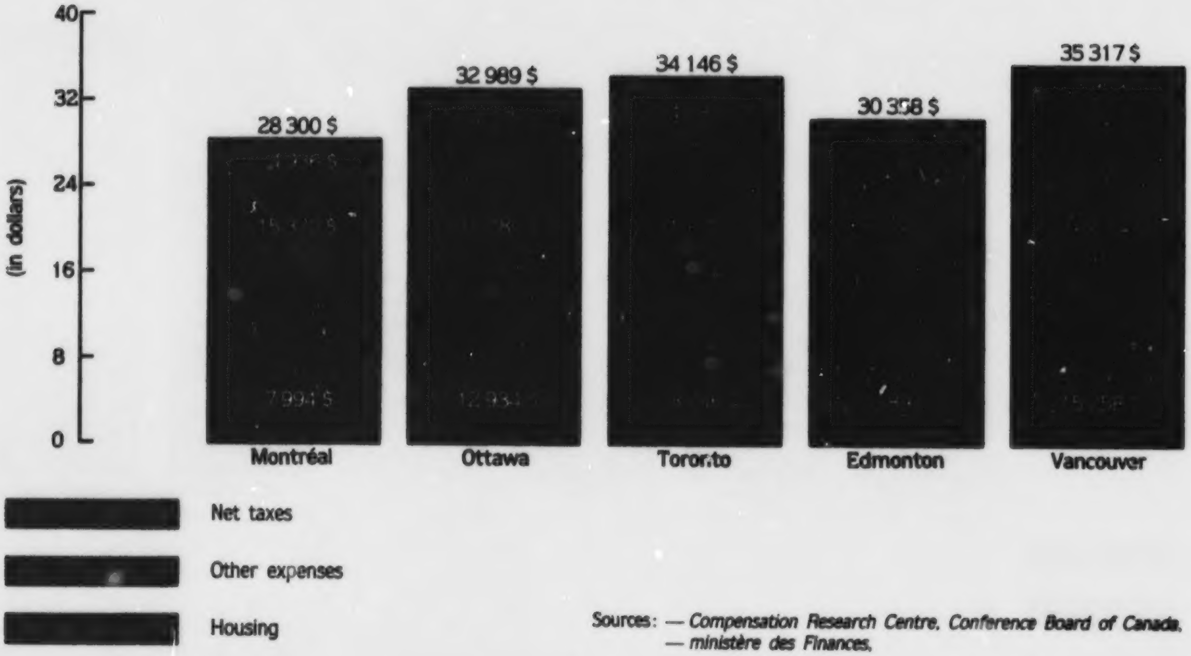


Diagram II.4

Household n° 4: Couple earning 30 000 $
both spouses working
Cost of living in September 1983



Sources: — *Compensation Research Centre, Conference Board of Canada.*
— *ministère des Finances.*

Diagram II.5

Household n° 5: Couple earning 50 000 $
one spouse working
Cost of living in September 1983

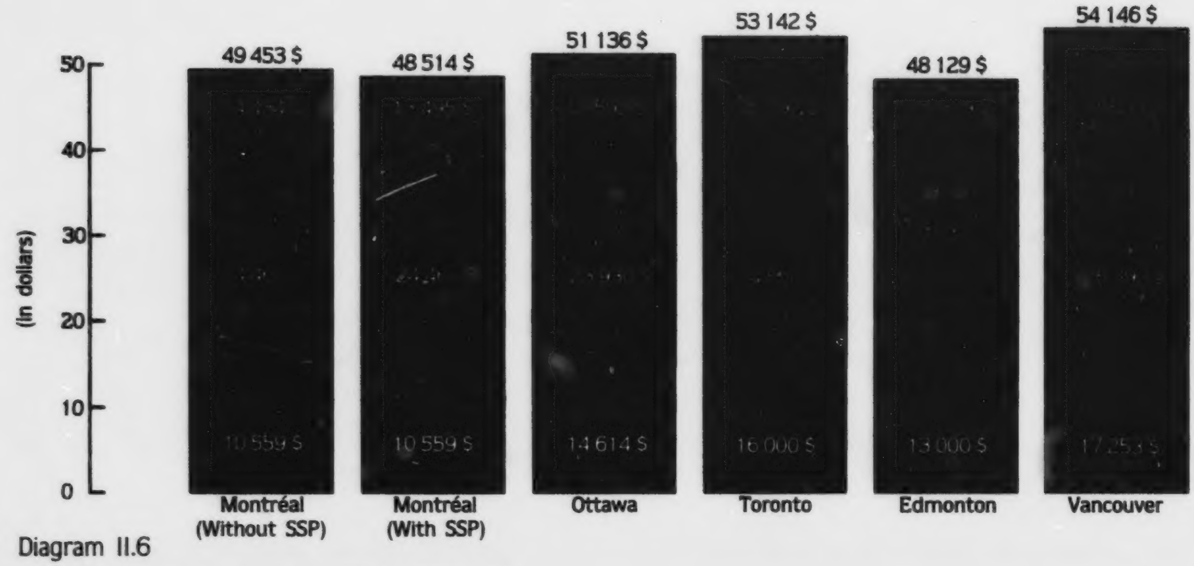
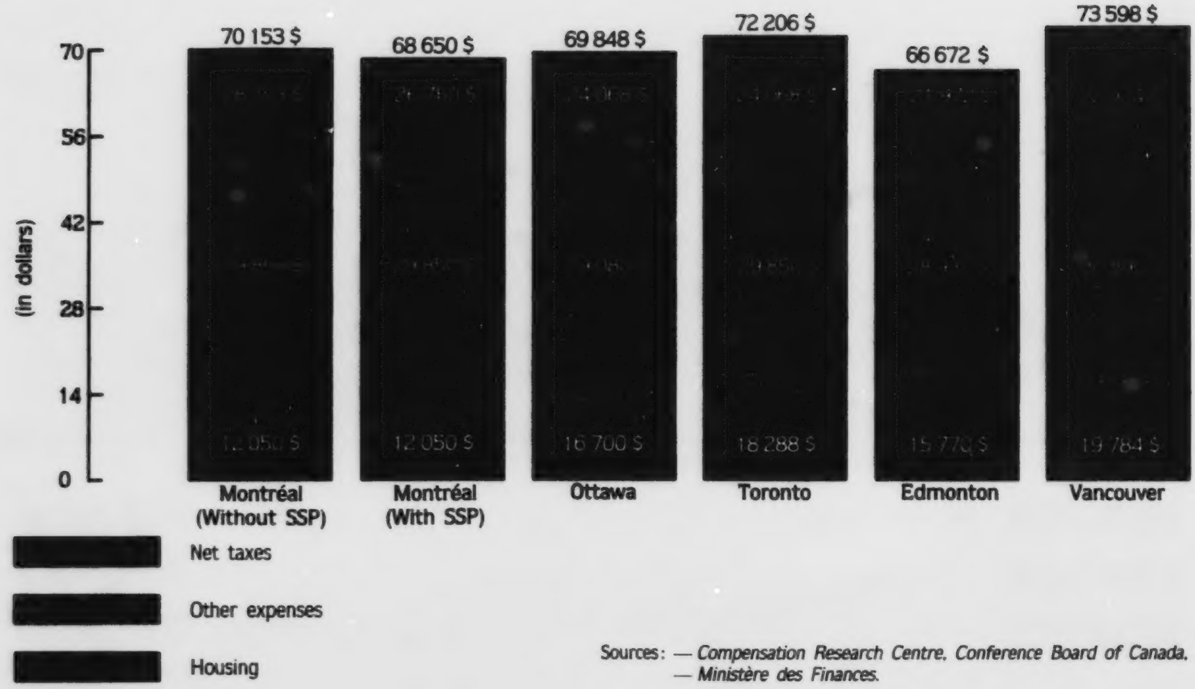


Diagram II.6

Household n° 6: Couple earning 75 000 $
one spouse working
Cost of living in September 1983



Sources: — *Compensation Research Centre, Conference Board of Canada.*
— *Ministère des Finances.*

Household 1, earning $10 000, represents the situation of a worker paid at slightly above the minimum wage, which is less than a third of the average household income of Québec families. This worker will spend 9% less to satisfy his basic needs if he lives in Montréal rather than Vancouver, 5% less than in Ottawa and Toronto, and 4% less than in Edmonton. In absolute terms, the differential in favour of Montréal varies between $350 and $845 depending on the city, and stems primarily from lower housing costs in Montréal. For this household, taxes are also lower in Montréal than in the other cities studied except for Edmonton.

Household 2 represents the situation of a married couple, where only one spouse works outside the home and earns an income of $20 000 which is slightly below the average industrial wage. The couple living in Montréal enjoys the lowest cost of living, although there is a 5% or smaller difference in relation to the cost of living in Edmonton, Ottawa and Toronto. However, it is 9% higher in Vancouver. The differential in favour of the couple living in Montréal ranges from $608 to $1 712, for the same reasons as in the case of Household 1.

Household 3 represents the situation of a married couple, where both spouses work outside the home, earning $20 000 and $10 000 respectively. Total household income is slightly below the average income of Québec families (about $31 000). For this couple, differences in the cost of living in the above mentioned cities are substantial ($2 429 to $7 494), primarily because of the relatively lower price of single-family dwellings in Montréal. To procure the lifestyle defined for Household 3, the couple living in Montréal requires 27% less for consumption expenditures and tax payments than the one in Vancouver, 23% less than their counterparts in Toronto, and 18% less than in Ottawa. Because of the lighter tax burden in Alberta, the overall cost of living in Edmonton is only 9% higher than in Montréal. The Québec couple pays substantially the same amount in taxes, net of related transfers and credits, as their counterparts in Ontario. However, housing costs are $5 752 lower than in Toronto, which indicates there is a decided advantage for this type of household to live in Montréal.

The results obtained show that it is possible for a couple living in Montréal and earning $30 000 to own a single-family dwelling and afford the standard of living defined for Household 3. Couples in Ottawa, Toronto and Vancouver will need a gross income of about $38 000 to $40 000 to afford the same standard of living, which will require additional outlays of between $5 000 and $7 000 on their part. This also means that couples in these cities earning $30 000 a year will have to make do with a lower standard of living than they would have had in Montréal.

The conclusions drawn with respect to Household 3, with both spouses working, also apply to Household 4, where only one works, since the lifestyles defined for each are essentially the same.

For the couple earning $50 000 per year and living in an upper-middle class neighbourhood (Household 5), Edmonton is the cheapest city to live in because of Alberta's light tax burden. Montréal, where the cost of living is 3% higher than in Edmonton, ranks second. However, Montréal comes close (1% differential) to Edmonton if an SSP contribution equal to the average deduction claimed in 1981 by taxpayers at the same income level is assumed. On the other hand, it costs 7% and 9% more for this couple to live in Toronto and Vancouver, respectively, rather than in Montréal. The difference is 2% higher if the SSP is taken into account.

Taxes and social contributions payable by this type of household are higher in Québec than in the other provinces. However, the additional burden is more than compensated for by the low cost of housing compared to Ontario and British Columbia. Even without considering the SSP, it costs about $3 000 more in Toronto than in Montréal for Household 5 to maintain its lifestyle, and $5 000 more in Vancouver.

For Household 6, which earns $75 000 per year, the differences in the cost of living in various Canadian cities tend to dwindle as the additional tax burden in Québec counterbalances the advantages of the low cost of housing. If the SSP is not considered, it costs 5% less for Household 6 to live in Edmonton rather than in Montréal, which, along with Ottawa, is the second cheapest city. When the SSP is taken into account, the situation is reversed and Montréal is back in second place, ahead of Ottawa. On the other hand, despite the family's high income, it is still less expensive for Household 6 to live in Montréal than in Toronto or Vancouver.

2.3.3.4 Conclusions

Considered separately, the Québec tax system might have a major impact on the location of business and the incentive to reside in Québec because of the higher tax burden imposed on middle and high-income earners. Such a situation could also hinder Québec's development by discouraging specialized workers, professionals, managers and company executives capable of creating new economic activities and new jobs from settling here. This may be detrimental to Québec as regards the location of a business, particularly one calling upon specialized workers or facing international competition.

Nevertheless, it must be emphasized that the tax burden is not the only crucial factor affecting the decision to move from one province to another. Each component of the cost of living, such as housing, food, clothing, must be taken into account.

Managers and employees earning high incomes, except those earning incomes in the very high range of $100 000 for example, are not generally penalized when they relocate in Québec. The lower cost of housing more than compensates for the greater tax burden borne by high-income taxpayers in Québec compared with those in Ottawa, Toronto and Vancouver, making the advantage of living in Montréal considerable. Edmonton residents earning more than $50 000, because of their tax burden — the lightest in Canada — enjoy the lowest cost of living among the cities studied.

Taxpayers earning low or average incomes will always benefit from living in Québec because of lower taxes and housing costs. For households earning less than $20 000 and living in apartments it costs as much as 7% less to live in Montréal than in the other cities considered.

However, it is at the level of households with average incomes ($30 000 a year) and owning single-family homes that Montréal's advantage is most significant. For the way of life of this household, the overall cost-of-living differential in favour of Montréal varies between 4% and 27% over Ottawa, Toronto, Edmonton and Vancouver. This differential is due essentially to the high cost of single-family residences in the latter cities. It may even be asserted that Québec is the only province considered, apart from Alberta, in which such a household may hope to own its home without having to count on government home-ownership assistance programs.

However, the last conclusion does not mean that the thorny problem of the tax burden of individuals in Québec must be set aside. On the contrary, the study clearly illustrates, on the basis of simple examples, the burden which must be borne by high-income taxpayers in Québec.

Moreover, although it has been shown that lower housing costs in Québec compensate for the additional tax burden, there is no doubt that taxpayers will always be more reluctant to pay taxes which cannot be reclaimed than to make payments on a house likely to secure a capital gain in the future. It is to be expected that the capital gain will be greater in cities where the value of houses is higher. This is an important factor which may have a negative influence on the desire of certain taxpayers to live, work and produce in Québec particularly among high-income workers who invest, or who are involved in the management or administration of a business. On the other hand, a reduction of the personal income tax burden for high-income earners would enable its citizens who wish to produce and reside in Québec to really benefit from Québec's comparative advantage with regard to cost of living. And Québec's economic growth would be greatly facilitated.

2.4 Summary and Conclusions

In this chapter we have described the various characteristics of Québec's tax system as it applies to individuals, and analysed it in relation to objectives defined in Chapter I, that is, in terms of:

- The social objective: the tax system must permit an acceptable redistribution of income;
- economic objectives: the tax system must preserve the competitive character of the economy and ensure its efficiency; and
- general objectives: the system must be fair to all taxpayers as well as simple to administer and easy to understand.

The objective of collecting sufficient revenues, as such, has not been examined in this chapter; this is, in fact, more of a constraint than an objective. This section summarizes the main conclusions of Chapter II with regard to each of the above objectives.

2.4.1 The income redistribution objective

Québec's tax system redistributes income to a considerable extent. This becomes all the more apparent when it is compared to Ontario's tax system. Low-income taxpayers generally pay less tax of all sorts in Québec than they do in Ontario, while all high-income workers pay more.

The greater redistributive capacity of Québec's system is attributable to the choices Québec has made regarding the use of various taxation fields. First, personal income tax — the most progressive tax — is more important in Québec than in Ontario. On the other hand, health care insurance premiums — the most regressive tax, and in fact virtually a lump-sum tax per household — account for 6% of Ontario's tax revenues, but do not exist in Québec. Moreover, property tax is more important in Ontario, as it partly finances both the school system and the municipalities. In addition to these factors, personal income tax in Québec is much more progressive than that in Ontario.

Québec's consumption taxes are more regressive than those in Ontario and this somewhat offsets the overall progressivity of its tax system. Low-income wage earners pay more consumption taxes in proportion to their income in Québec than in Ontario, while those with high incomes pay less. Québec's higher fuel tax is the main reason; it is more regressive than the average consumption tax. Second, primarily because of the selective exemptions which apply to certain essential goods of which high-income workers consume relatively more than others (e.g. furniture). Québec's sales tax is more regressive than Ontario's. Third, it must also be noted that the absence of a sales tax credit in Québec accentuates the differential in the regressivity of the sales tax.

Generally speaking, the Québec and Ontario tax systems are highly progressive; Québec's system is the more progressive of the two. While the average rate of all taxes payable by an Ontario family with a single income and two children under six increases from 13.8% to 40.0% when income rises from $15 000 to $75 000, it soars from 6.7% to 44.9% in Québec.

Objectives to be attained with regard to the redistribution of income are unclear, and are not widely agreed upon, thus making it difficult to assess to what extent they have been reached. Nonetheless, it may be concluded that the progressivity of Québec's tax system is higher than that of Ontario in this respect. In Chapter III the relation between the progressivity of the tax system and the distribution of income will be studied in greater detail.

2.4.2 Economic objectives

2.4.2.1 Preserving the competitive position of the economy

If we start by examining the competitive nature of the tax system, a first conclusion becomes very apparent. Québec attaches considerably more importance to taxing production than to taxing consumption and wealth than Ontario does. Taxes on production account for 42% of Québec's revenue, compared with only 30% in Ontario. The additional burden on production activities is attributable primarily to the personal income tax payable by middle and high-income earners. It is to be noted that this greater proportion of taxes on production applies to an overall tax burden 10% higher under Québec's tax structure than under the Ontario structure.

For its part, Ontario chose to tax wealth more heavily by intensive use of property taxes for school purposes. Financing of health services is ensured in part by a fixed premium per household which has little relation to ability to pay. These choices enabled Ontario to avoid taxing production activities too heavily and thus to reduce the negative effects of taxation on the economy.

As for evaluating the impact of the tax system on taxpayer's decision to reside in Québec and the ability of firms to attract the staff they need here, the conclusions may be different. From the strict point of view of taxation, Québec taxpayers are at a disadvantage in relation to their Ontario counterparts in high-income brackets, which could discourage specialized staff from settling here and create problems for companies looking for this type of manpower. However, it is possible to appreciably attenuate this disadvantage by contributing to the Québec Stock Savings Plan.

Taxpayers must consider cost-of-living components other than taxes when deciding on whether to relocate. In this regard, Québec, including Montréal, enjoys a clear advantage. The study quoted in this chapter indicates that the cost of living is lower in Montréal and that, in most cases this situation compensates for the effect of higher taxes. Only for those with very high incomes is the overall cost of living higher in Montréal in relation to the other cities considered. Furthermore, the study shows that in Montréal taxpayers in middle-income brackets can enjoy a lifestyle which would be impossible in the other cities considered aside from Edmonton.

On the other hand, it must be recognized that the possibility of a capital gain on houses is higher in other cities than in Montréal, in which case, Montréal's advantage could vanish. It is therefore plausible that the capital gain on a $100 000 home in Toronto will be greater than on the same house, worth only $55 000, in Montréal. It is possible that homeowners, that is, households with high incomes, feel that they are at a disadvantage when transferred to Montréal, especially if they perceive buying a home as a form of investment.

It would be in Québec's interest to become more competitive in regard to the taxation of average and high incomes. That would benefit skilled manpower and thus facilitate the location of firms in Québec. It would also enable Québec to benefit more fully from its comparative advantage with respect to housing and cost of living, and to profit in terms of economic growth.

2.4.2.2 Ensuring economic efficiency

The effects of the Québec tax system on the incentive to work will be studied in greater detail in Chapter III when dealing with the impact of transfer programs. A number of conclusions specific to the tax system may, nonetheless, be drawn. With regard to this particular problem of the incentive to work, Québec's highly progressive tax system gives rise to certain problems. The level of marginal income tax rates has a considerable effect on individual choices between work and leisure, remunerated and domestic work, or even legitimate employment and work in the **underground economy**. The marginal tax rate represents the portion collected by the government of each additional dollar earned by the individual who furnishes supplementary work effort.

Regardless of the type of household or income considered, the marginal income tax rate in Québec is higher than that in Ontario. For a taxpayer taxed at the maximum marginal rate, the discrepancy is 10 percentage points. Given the greater importance of income tax in Québec, it could hardly be otherwise. It is for this reason that Québec's tax system is more likely to dampen the incentive to work than that of Ontario.

Most of the disparity with regard to the maximum marginal income tax rate has developed recently, and resulted from the fact that Québec did not harmonize its tax system with the provisions of federal Finance Minister Allan MacEachen's budget in 1982, which reduced the tax rate applicable to high-income workers as well as the tax shelters available to them. In the end, few of these exemptions and deductions were eliminated with the result that the tax burden of these taxpayers was substantially decreased. Trapped by the effects of the recession on its budget, Québec did not follow suit, while the other provinces, bound to the federal government by their tax agreements, had to harmonize their tax system.

Furthermore, the fact that the employment expenses of wage earners are not fully deductible not only creates a problem of equity, but also reduces the incentive to work. The effect is especially obvious with regard to child care expenses for young children: the allowable deduction may, in some cases, cover only two-thirds of the expenses actually incurred. There are also increased expenses related to the reduced time available for household work, a portion of which could be done by another person. All of these factors act to discourage heads of single-parent families from working and spouses in two-parent families from entering the labour market. As far as expenses related to studies are concerned, the fact that they are only deductible in part, and cannot be carried over or tranferred, is not much of an inducement for the individual to further his education.

As regards the extent to which the tax system encourages people to save and, ultimately, invest, it has already been demonstrated in this chapter that, during periods of inflation, the current tax system taxes unduly the return on savings. During such periods, a considerable portion of interest and dividend payments only compensates for the loss in purchasing power of financial assets generated by inflation. Taxing the portion of interest and dividends that corresponds to the protection of the investment's real value is equivalent to taxing the savings portion of income already taxed. In economic terms, this negatively affects savings and investments by appreciably reducing their profitability during periods of inflation.

The deduction with respect to the first $1 000 of interest and dividend income was designed to offset the pernicious effects of inflation on such income. However, it is not very fair, as it is granted to all taxpayers, regardless of their financial assets. For anyone with substantial savings, the deduction provides only scant tax relief. But other fiscal measures have been established to encourage saving, in particular registered retirement savings plans, stock savings plans, registered home ownership savings plans, and indexed securities investment plans. It is generally thought that such plans explain the greater rate of saving in Canada than in the United States. The tax system attributes a special status to those who own certain assets, such as their principal residence. Moreover, half of capital gains are exempted from tax; this is also an inducement to save.

Despite the scope of the problem, Québec has little room to intervene alone as regards broadening the tax base to include the net increase in wealth because of the mobility of capital. The question should be discussed by the federal and provincial governments with a view to achieving optimum common policies, with the understanding however that policies that differ excessively from those of the United States cannot be adopted. However, Québec has greater freedom of action with respect to the taxation of savings if the proposed measures encourage investment.

2.4.3 General objectives

2.4.3.1 Equity

The objective of equity can be achieved only insofar as a tax system based on the ability to pay affords identical treatment to taxpayers showing the same socioeconomic profile. The evaluation of the ability to pay raises three questions. Is the taxpaying unit on which the tax system is based neutral with respect to the household's make up? Does income liable to taxation or sales subject to consumption taxes affect individuals equitably? Do the deductions granted to them benefit taxpayers equitably? Each question will be examined in turn.

— The taxpaying unit

The present tax system involves certain inequities stemming from the choice of the taxpaying unit.

First, the system does not recognize that a de facto spouse may be the dependent of a taxpayer, and only grants the exemption for spouses to married couples. However, in both cases, the essential needs of the person are precisely the same, a fact recognized by the transfer system. Moreover, the equivalent of the married exemption for the first child of a single-parent family and the exemption accorded because of age seem to be higher than the amount needed for the essential needs to which they are supposed to correspond.

The lack of personal exemptions for dependent children poses a problem of fairness, despite the existence of non-taxable family allowances. In the upper echelons of income, the current system taxes a portion of the income required to ensure the essential needs of dependent children, as family allowances only partly compensate for taxes paid on income used to defray the cost of essential needs.

Finally, the tax system is unfair with regard to those with dependent children and wishing to enter the labour market, to the extent that the expenses incurred to hold a job are not completely recognized.

Furthermore the taxation unit concept used by the tax system grants a substantial advantage to a household where income is earned by both spouses. Because of the progression of tax rates and higher total tax exemptions, the couple in which one spouse earns $30 000 pays more income tax than one in which both spouses earn $15 000 each. To some extent, the different treatment is justified by the additional expenses related to the presence of a child, especially those arising from housework, incurred by the household in which both spouses work, or by the fact that the spouse remaining at home does a job which has an economic value but which is not taxed. However, as income increases, the differential in taxes payable by both households increases, and becomes disproportionate to the implicit value of the work done by the spouse who remains at home, and to the additional expenses related to the employment of the second spouse.

— Income and sales subject to tax

To be fair to all taxpayers, all sources of income should be taxed equally, as should all categories of consumer goods. Otherwise, some taxpayers who carry on particular non-taxable activities enjoy an advantage, to the detriment of others. Many problems exist in this regard.

With respect to consumption taxes, a number of exemptions and a variety of rates apply. On the other hand the fact that consumption tax rates are generally lower than those for income tax limits the consumption tax's distortion of the economy.

The base for income tax offers fewer possibilities for exemptions and covers most income. However, income derived from the ownership of the main residence (capital gains and interest income implicit in the equity) is exempt under the tax system. Freedom to act in this respect is nonetheless severely curtailed by the fact that Québec's tax system is already much more progessive than that of other provinces of Canada. In this area, it is preferable to maintain the harmonization of the federal and Québec systems. Part of the advantage granted in regard to the principal residence may be recovered through succession duties, which would be quite as justified in the other provinces.

Other exemptions cover various transfers from the government to individuals (social aid and the guaranteed income supplement are the most important). Benefits under these programs are not subject to income tax on the grounds that such transfers are not normally paid to those who are liable to pay tax, which is not always the case.

— Allowable deductions

Two types of objectives are pursued by income tax deductions. On the one hand, they are intended to take into account expenses incurred to earn income. On the other, they are aimed at a variety of more specific goals which the government wishes to pursue through the tax system. Numerous questions have arisen with respect to the equity of certain deductions. The most frequent one concerns the unfavourable treatment accorded to employment income in relation to business and property income; allowable deductions are much greater in the second instance than in the first.

These questions have not been analysed in the *White Paper* because of the complexity of the problem, and because of the need to preserve the greatest possible degree of harmonization between the federal and provincial tax systems, in order to avoid exacerbating the problems of fiscal competition faced by Québec. Questions arising from tax expenditures should be dealt with at a federal-provincial conference. However, it is possible to take action with respect to expenses related to employment and those related to studies.

2.4.3.2 Administrative simplicity

Since the 1972 tax reform, the tax system has become more and more complex. Legislation has continued to proliferate, with the inevitable result that considerable energies must be devoted to studying it. In addition, an increase in tax rates may drain off sizable resources with a view to avoiding taxes. Any future reform will assuredly have to focus on the objective of simplicity. The tax system's credibility is at stake; it is also a question of collecting tax revenues as efficiently and as cheaply as possible.

Characteristics of the Transfer System and Problems of Integration with the Tax System

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Chapter III

Characteristics of the Transfer System and Problems of Integration with the Tax System

Québec's tax and transfer systems should be very closely interrelated to ensure they reach their objectives. Before broaching the question, in the first section of this chapter we present a brief description of the main components of the Québec system of transfers to individuals.

In succeeding sections, the Québec transfer system is analysed in terms of the various objectives it should pursue. To begin with, the components of the basic minimum income and its development over time are examined. This is followed by a comparison of the basic minimum income for individuals and households guaranteed by the Québec transfer system with their subsistence expenses and the essential needs recognized under the tax system, as well as with the benefits paid by Ontario. The following points will then be covered: compensation for family responsibilities, social aid for special needs, the situation with respect to students and persons 65 or over, and **Indexation***
of the components of the basic minimum income.

Subsequent sections deal with the transfer system in relation to the objective of economic efficiency and incentive to work and examine the impact of the taxation of income and the reduction of transfer benefits as employment income rises, and of the increase in child care costs when a household has children. The system is then examined in terms of the objectives of income redistribution and equity among taxpayers. Finally, the last section deals with more specific questions as regards the integration of programs with other parts of the tax and transfer systems, their coordination with government policies and their effects on the economic and social behaviour of beneficiaries.

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* Terms in boldface type are defined in the glossary.

3.1 General Description of the Transfer System and Its Main Programs

There is no single definition of the system of transfers to individuals. Such a system may cover a limited or very large number of programs and measures, from social aid to free education, including retirement plans. For the purposes of this chapter, the Québec transfer system may be described as a group of programs that performs the following functions:

- it guarantees a basic minimum income, including compensation for family responsibilities;
- it protects employment income;
- it provides financial assistance for participation in the labour market.

Thus, each of the programs making up the system may be classified under the heading of one purpose, it will be classified according to its main function. We shall now describe each of these three functions in greater detail and see how it is guaranteed by the transfer system.

3.1.1 The guarantee of a basic minimum income

In Québec, the programs and measures which perform the function of guaranteeing a basic minimum income can be divided into three main groups as illustrated in Table III.1.

The first function consists in guaranteeing a basic minimum income for individuals and families who do not have sufficient financial resources to provide for their essential needs. Under the present transfer system, these needs are met mainly by social assistance programs, backed up by a number of supplementary programs of compensation for family responsibilities arising from the presence of children: the universal federal and Quebec family allowance programs, the federal child tax credit and the availability allowance. Another group of programs of financial aid or social services is designed to provide government assistance recipients with essential services.

Table III.1
Programs related to a guaranteed basic minimum income according to target population[1]

	Households whose head is under 65	**Households whose head is 65 or over**
Main program	— Social aid (Q)	— Old Age Security Pension (F) — Guaranteed income supplement (F) — Spouse's allowance (F)
Supplementary programs for family responsibilities	— Federal family allowances (F) — Québec family allowances (Q) — Federal child tax credit (F) — Québec availability allowance (Q)	Households in this category with eligible children may also benefit under these programs.
General supplementary programs	— Property tax refund (Q) — Special needs under social aid (Q) — Legal aid (Q) — Housing grant (low rental housing, COOP, etc.) (Q)	— Housing allowance (LOGIRENTE) (Q) — Property tax refund (Q) — Free drugs (Q) — Free ambulance services (Q) — Legal aid (Q) — Housing grants (low rental housing, COOP, etc.) (Q)

1. Benefits under programs indicated by (Q) are paid by Québec; those under programs indicated by (F) are paid by the federal government. However certain programs, such as social aid, are jointly funded.

Mention must also be made of a the loans and scholarships program to provide a basic minimum income for a very specific target population — college and university students.

3.1.2 Protection of employment income

This protective function serves as a replacement for income from employment when a socio-economic hazard becomes a reality, a work accident or unemployment, for example. The function of protecting employment income is carried out mainly by a public savings program with a view to retirement and by various social insurance programs. Because of the insurance and savings accumulation aspects of these social insurance programs they usually only benefit those who have paid premiums or social contributions to insure themselves against the loss of their earned income.

The elements of Québec's employment protection system can be grouped as follows:

• Retirement	— Québec Pension Plan (Q)
• Unemployment	— Unemployment insurance (F)
• Childbirth	— Maternity allowance (Q) — Unemployment insurance (F)
• Disability, sickness or death	— Compensation for victims of work accidents and occupational diseases (Q) — Automobile Insurance Plan (Q) — Québec Pension Plan (Q) — Unemployment insurance (F) — Compensation for victims of criminal acts or civil actions (Q) — Veteran's pension (F)

3.1.3 Financial assistance for participation in the labour market

This function made its appearance more recently in the system of transfers to individuals. It became necessary, in fact, when the amount of benefits paid to non-working households equalled or even exceeded the income earned by certain full-time workers once they had defrayed the additional costs involved in holding a job. This phenomenon was due primarily to the fact that transfer programs take the size of the family into account, whereas wages paid on the labour market do not.

This component is intended to encourage low-income workers to stay on the labour market rather than apply for social aid. For this purpose, Québec introduced the employment income supplement whose aim is to maintain an incentive gap between income from employment and social aid benefits, and the financial aid program for families using child care services, which is intended to reduce child care costs related to participation in the labour market. However, this program does not, at present, meet all needs, because assistance is limited to parents making use of child care facilities recognized by the Office des services de garde à l'enfance.

3.1.4 Field of analysis of the *White Paper*

It is easy to see that the system of transfers to individuals constitutes a complex set of measures consisting of elements that are highly diversified with respect to their nature, their method of operation and their objective. Several of these programs may, however, be omitted from the field of analysis of this *White Paper*. On the one hand, since the federal transfer programs cannot be modified, or replaced, it is of little use to analyse them here. Nonetheless, their effects must be taken into account since, in their own way, they help or hamper achievement of the desired objectives.

On the other hand, because of the vast extent of the task, only programs directly related to the tax system must be considered. All the basic minimum income guarantee programs meet the criterion, for the tax system pursues the same objective of not taxing income required to meet what are considered to be essential needs and it is necessary to ensure that the means used by the two systems will be compatible. For the same reasons, programs designed to encourage participation in the labour market must also be considered.

It seems less useful and relevant to examine the social insurance plans. Because of their role of insuring against risks connected with loss of earned income, these programs have a different approach and thrust from that of the other income security programs. Since the goals of these programs have little to do with the taxation system, they will not be discussed in this paper.

The following is therefore the list of programs analysed in the *White Paper*, relating to the following functions:

▪ A guaranteed basic minimum income:	
(a) for families whose head is under 65 and single persons in the same age group:	– Social aid – Québec family allowance[12] – Availability allowance[12] – Special needs – Property tax refund[12] – Legal aid – Housing grant (low rental housing)
(b) for households whose head is 65 or over and single persons in the same age group:	– LOGIRENTE – Property tax refund[12] – Legal aid – Housing grant (low rental housing) – Free medication – Free ambulance services
▪ Assistance for participation in the labour market	– Employment income supplement – Financial assistance for families using child care services

It shoud be noted that not all aspects of these programs will be considered, but primarily their interrelations with the tax system, and their impact on the objectives of the tax and transfer system mentioned in Chapter I.

3.2 The Basic Minimum Income Guaranteed by the Transfer System

As we have seen, the function of guaranteeing a basic minimum income is one of the most important functions of Québec's income security system. This function plays a major part in attaining the objective of income redistribution. In this section, we shall first of all identify the elements of this basic minimum income for persons who are not studying and are under 65 years of age and outline the historical development of the basic minimum income guaranteed by the State and of its target population. Then, in order to adequately evaluate this basic minimum income guaranteed to different types of households by the Québec transfer system, it will be compared with the present system in Ontario and also with the level of what may be described as essential needs.

3.2.1 Elements of the basic minimum income guaranteed by the State

At the present time the State administers financial assistance programs for persons who are unable to provide for their own subsistence needs or those of their dependents. The body of programs which act to guarantee a basic minimum income has two main components, social aid, on which the income support policy is based, and a number of complementary programs designed to meet certain specific needs of low-income earners: family allowances, availability allowance, property tax refund, social aid for special needs, federal child tax credit, etc. It is the effect of all these various programs that guarantees that low-income households will be able to satisfy their essential needs.

The social aid program constitutes the main element of the basic minimum income for persons under 65 years of age. Apart from a few exceptions, any single person or family in need is eligible for the social aid program. Households covered by this program include single persons and families consisting of the father, mother, children under 18, and children 18 or over if they are studying. Social aid pays monthly benefits that are supposed to cover ordinary household needs (food, clothing, housing, personal and domestic needs, educational expenses) as well as special needs (medication, dental services, prescription glasses, false teeth, transportation for medical purposes).

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[12] These programs were already considered in Chapter II.

The social aid benefits for ordinary needs depend on the number of adults and number of children in the household, and on the type of family (one or two-parent). The amount of assistance is frozen when the household has more than two children, given that the social aid program is harmonized with the family allowance program. It is in fact considered that family allowances compensate fully for the essential needs of children starting from the third. Moreover, the cut-off point for social aid benefits is fairly low for single persons and childless couples who are able to work and under 30 years of age ($149 and $298 a month respectively as of October 1983). Moreover, benefits are reduced by $85 a month for households living with a parent or child, except in the case of those already subject to the reduced scales.

In addition to social aid, almost all[13] households — owners, tenants and persons living in a rooming house — are entitled to a refund of property tax payable on the dwelling in which they live. This refund of 40% decreases when the household income exceeds a certain level. When the household includes one or more children, it is entitled to a whole range of government programs including federal and provincial family allowances, the federal child tax credit and the availability allowance. These benefits are in addition to social aid and the property tax refund.

Among the other programs available to low-income families, particular mention must be made of low-cost public housing and legal aid, measures which involve large subsidies for a relatively small number of people.

The elements of the basic minimum income are set out in Table III.2 for twenty typical households chosen to illustrate the characteristics of the income security system, and representing as far as possible the various types of households whose head was a social aid beneficiary in June 1983.

In many countries the level of income guaranteed for **persons able to work** is lower than that guaranteed for those who are not considered able to work. This is a way of recognizing that the situation of dependence of persons able to work is, or should be, a temporary situation, which is not the case with the disabled. Persons able to work who participate in training programs are obviously in a special situation; by giving them higher benefits (which is not always the case in Québec), the State is actually investing in their reintegration into the labour market. For the purposes of this paper, only cases where the head is able to work (296 895 households in June 1983) have been chosen,[14] since the case of **persons who are unable to work** is affected only slightly by the tax system.

Table III.2 indicates the number of households whose head is able to work and under 65 and the proportion this number represents in relation to the total number of households with social aid beneficiaries who are considered able to work. The set of typical cases chosen represents about 87% of all households on social aid whose head is able to work and under 65 years of age. The basic minimum income consists of social aid (ordinary and special needs), federal and provincial family allowances, the federal child tax credit, the availability allowance and the property tax refund. The total given represents the total amount of government aid these persons receive.

As a general observation, variations in the basic minimum income depend mainly on the number of persons in the household; there is a considerable difference between the benefits paid to single persons and couples under the age of 30, and those given to other groups.

3.2.2 Historical evolution of the basic minimum income guaranteed by the State

The present structure of the programs guaranteeing a basic minimum income dates from 1974. However several changes, of two kinds, have been made since that time. First, the benefits have been periodically adjusted to the cost of living. Second, new complementary programs were introduced during this period.

Among the new programs introduced were the property tax refund in 1979 and the availability allowance in 1981. These two measures did not result in an equivalent readjustment in social aid benefits and consequently there was an increase in the disposable income of the recipients.

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[13] Exceptions are households that live in subsidized housing or in a reception centre or extended care hospital centre.

[14] Persons able to work include those who are temporarily unfit for work, but generally not those aged 60 and over or those 55 and over who have been absent from the labour market for at least five years. A family is considered to be able to work if one of the spouses is fit to work.

Table III.2

Elements of the basic minimum income in Québec for certain households receiving social aid whose head is able to work
(1983)

	Recipients able to work		Elements of basic minimum income ($)	
Type of household	**Number of households**[1]	**Proportion (%)**[2]	**Social aid ordinary needs**[3]	**Québec family allowance**
1. Single person 18-20 resident*	35 050	11,8	1 758	—
2. Single person 18-20	8 507	2,9	1 758	—
3. Single person 21-29 resident*	33 498	11,3	1 758	—
4. Single person 21-29	21 734	7,3	1 758	—
5. Single person 30-64 resident*	10 144	3,4	3 795	—
6. Single person 30-64	59 139	19,9	4 815	—
7. Childless couple — 2 spouses under 30	3 393	1,1	3 516	—
8. Childless couple — 2 spouses 30-64	10 472	3,5	7 650	—
9. Single parent — 1 child (0-6) — resident	3 341	1,1	5 532	90
10. Single parent — 1 child (0-6) — non-resident	16 962	5,7	6 552	90
11. Single parent — 1 child (6-11)	8 808	3,0	6 587	90
12. Single parent — 1 child (12-17)	9 349	3,1	6 587	90
13. Single parent — 2 children (0-6)	3 502	1,2	7 098	211
14. Single parent — 2 children (6-11)	3 024	1,0	7 168	211
15. Single parent — 2 children (12-17)	3 558	1,2	7 168	211
16. Two parents — 1 child (0-6)	7 906	2,7	8 268	90
17. Two parents — 1 child (6-11)	2 363	0,8	8 303	90
18. Two parents — 1 child (12-17)	4 292	1,4	8 303	90
19. Two parents — 2 children (0-6)	4 319	1,5	8 772	211
20. Two parents — 2 children (6-11)	1 655	0,6	8 842	211
21. Two parents — 2 children (12-17)	2 228	0,7	8 842	211

1. The number of households receiving social aid in June 1983 corresponds to the situation of the non-resident household unless otherwise indicated. The term "able to work" has the same meaning as in footnote 14 (Chapter III).
2. Proportion in relation to the total number of households whose head is capable of working (296 895 households in June 1983).
3. The amount of social aid is based on the annual average of 1983 scales and includes educational expenses of 35 $ granted in August for children of school age.

* Residing with a parent or child. It is assumed that these persons do not receive a property tax refund. All other households are deemed not to be residing with a parent or child.

Table III.2 (continued)

Elements of the basic minimum income in Québec for certain households receiving social aid whose head is able to work
(1983)

Type of household	Elements of basic minimum income ($) (cont'd.) Federal families allowance	Federal child tax credit	Availability allowance	Property tax refund	Basic minimum income	Social aid special needs[4]	Total assistance
1.	—	—	—	—	1 758	145	1 903
2.	—	—	—	38	1 796	145	1 941
3.	—	—	—	—	1 758	145	1 903
4.	—	—	—	38	1 796	145	1 941
5.	—	—	—	—	3 795	224	4 019
6.	—	—	—	117	4 932	224	5 156
7.	—	—	—	83	3 599	351	3 950
8.	—	—	—	171	7 821	494	8 315
9.	205	343	300	—	6 470	186	6 656
10.	205	343	300	153	7 643	194	7 837
11.	205	343	—	149	7 374	226	7 600
12.	291	343	—	150	7 461	254	7 715
13.	532	686	500	166	9 193	229	9 422
14.	532	686	—	162	8 759	267	9 026
15.	703	686	—	165	8 933	286	9 219
16.	205	343	300	187	9 393	429	9 822
17.	205	343	—	185	9 126	502	9 628
18.	291	343	—	185	9 212	524	9 736
19.	532	686	500	205	10 906	474	11 380
20.	532	686	—	196	10 467	541	11 008
21.	703	686	—	199	10 641	555	11 195

[4] The amount of social aid for special needs is based on the estimated average amount paid for all special needs (drugs, dental services, glasses, false teeth, transport for medical purposes) to all social aid recipients of each household category, whether the head of the household is able to work or not.

Table III.3

Change in disposable income between 1974 and 1983
Single person 30-64
(in dollars)

	1974	1983	
		In 1983 dollars	In 1974 dollars
A. Social aid recipient			
Social aid benefit	2 089	4 815	2 156
Property tax refund	—	117	52
• Disposable income	2 089	4 932	2 208
• Change in disposable income	—	136%	6.6%
B. Worker earning average industrial wage			
Wage	9 024	21 500	9 629
Taxes and contributions	−2 027	−5 848	−2 619
• Disposable income	6 997	15 652	7 010
• Change in disposable income	—	124%	0.2%

1. Based on the change in the consumer price index for Montréal from 1974 to 1983 and on the change in disposable income.

With regard to indexation, it is important to specify that the particular benefits of each of the programs were not indexed but rather the total value of the components of the basic minimum income. When family allowances were not indexed or when the federal child tax credit was introduced, the social aid benefits were adjusted accordingly.

Because of the periodical indexation of the basic minimum income and the addition of new programs which were not considered in the calculation of its benefits, the disposable income of social aid beneficiaries has been maintained since 1974 in real terms, as shown in Table III.3 illustrating the case of a single person over 30. The disposable income of social aid beneficiaries has even gone up 7% in real terms while that of workers paid at the average industrial wage has remained stable, in real terms, in relation to what it was in 1974. On the other hand single persons under 30 have not always benefited from indexation of social aid benefits with the result that their real income declined by 20% between 1974 and 1983.

The real income of households with children receiving social aid improved slightly throughout this period, with the exception of households entitled to the availability allowance, whose standard of living in real terms improved a little more rapidly. A two-parent family with two children under six benefited from a 17% rise in its disposable income between 1974 and 1983, regardless of whether it received social aid or whether the breadwinner earned the average industrial wage. In the case of a single person over 30, however, the situation of the social aid recipient improved more than that of the person earning the average industrial wage. Moreover, the growth in the number of social aid recipients needs to be analysed.

The changes which have occurred since 1973 in the number of persons on social aid able to work and not able to work constitute an interesting phenomenon (see Table III.4). In order to present a homogeneous historical series, it should be noted that the definition "able to work" used here is less restricted than that used in Table III.2.

It can be seen that the number of social aid recipient households more than doubled in 10 years, increasing from 177 000 to 403 000. As was noted in the introduction, the most disquieting growth occurred in the able to work group, whose number multiplied by almost four in this period. A major increase (170%) also occurred among the number of single beneficiaries, which rose from 94 000 to 255 000. Although 1982 marked a break in the series (the number of recipients able to work having increased by 34%), the rate of increase in the other years was nonetheless very high — never less than 9%.

This high rate of growth may be attributed to a number of factors: tighter labour market, stricter eligibility conditions for unemployment insurance, marked growth in the labour force, a different attitude towards work, and so on. The contribution of each of these factors is difficult to assess. What is certain, however, is that Québec does not have the means to allow this rapid growth to continue indefinitely.

Table III.4

Evolution of number of social aid recipients by fitness to work[1]
(In December)

Year	Able to work		Unable to work		Total		Proportion of those able to work	Single persons	Families	Proportion of single persons
	N	Change %	N	Change %	N	Change %				
1973	69 196		108 176		177 372		39,2	94 203	83 169	53,1
1974	75 826	9,6	114 778	6,1	190 604	7,5	39,8	102 593	88 011	53,8
1975*	85 996	13,4	121 204	5,6	207 200	8,7	41,5	117 905	89 295	56,9
1976*	101 956	18,6	126 588	4,4	228 544	10,3	44,6	133 470	95 074	58,5
1977*	114 853	12,6	126 152	(0,3)	241 005	5,4	47,7	142 769	98 236	59,2
1978*	126 101	9,8	124 211	(1,5)	250 312	3,9	50,4	148 712	101 600	59,4
1979*	142 472	13,0	128 408	3,4	270 880	8,2	52,6	163 817	107 063	60,5
1980*	156 729	10,0	133 289	3,8	290 018	7,1	54,0	177 735	112 283	61,3
1981*	174 395	11,3	134 896	1,2	309 291	6,6	56,4	192 225	117 066	62,2
1982*	234 432	34,4	137 188	1,7	371 620	20,1	63,1	235 503	136 117	63,3
1983*	264 180	12,7	138 690	1,1	402 870	8,4	65,6	254 810	148 060	63,3

* After 1975, households 65 and over (pensioners) were added prorata to clients classified as able or unable to work. The number varied between 3 000 and 5 000 during the 1975-1983 period.

1. As opposed to the situation presented in Table III.2, the "unable to work" category takes in those who are temporarily unable to work, and so is broader than the definition given in footnote 14.

Source: *Monthly statistics on social aid recipients.*

3.2.3 Comparison with Ontario

Before passing judgment on the level of the basic minimum income guaranteed in Québec, it might be interesting to compare this level with the level of the basic minimum income for persons able to work guaranteed in Ontario. As in the case of the tax system, this comparison with Ontario shows where Québec stands in relation to the principal province of Canada and allows an assessment of the generosity of its social aid program for persons able to work.

In this comparison, the Ontario transfer system has been applied to individuals in Québec. Thus, the Ontario social assistance housing allowance was based on the average cost of housing paid by social aid recipients in Québec, which is lower than the maximum housing cost allowed under the Ontario regulations. Ontario's property tax credit was also calculated on the basis of this average housing cost. This comparison is presented in Table III.5. In the case of beneficiaires living with a relative, these were not considered to be entitled to the property tax credit or the temporary tax credit for heating costs, since they were neither the owners nor tenants of their dwelling.

Single persons under the age of 21 who live with their parents are not eligible for social assistance in Ontario (except as a child in a family), whereas they represent a considerable proportion of the clientele in Québec (11.8% of the total of those able to work). Single persons under 21, and not living with parents are, however, eligible and the total assistance they are guaranteed is almost twice what is guaranteed in Québec. The same situation exists for single persons and childless couples 21 to 29, wherever they reside. However, there is less difference between Ontario and Québec when these persons 21 to 29 live with a relative.

For single persons between the ages of 30 and 64,[15] the situation is just the opposite, in other words, total assistance in Québec for persons able to work is at least one-third higher than in Ontario, whether these persons live with family or not. Again, this constitutes a very large group in Québec, representing 23.3% of the total number able to work. The same applies for childless couples

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[15] With the exception of single women, aged 60 to 64, who, in Ontario, may be eligible under the *Ontario Family Benefits Act* under certain conditions.

Table III.5

Elements of the basic minimum income in Ontario and comparison with total assistance in Québec for certain households receiving social aid whose head is able to work
(1983)

	Elements of Ontario basic minimum income ($)		
Type of household	**Social assistance ordinary needs**[1]	**Federal family allowance**	**Federal child tax credit**
1. Single person 18-20 resident*	0	—	—
2. Single person 18-20	3 276	—	—
3. Single person 21-29 resident*	2 724	—	—
4. Single person 21-29	3 276	—	—
5. Single person 30-64 resident*	2 724	—	—
6. Single person 30-64	3 504	—	—
7. Childless couple — 2 spouses under 30	5 376	—	—
8. Childless couple — 2 spouses 30-64	5 424	—	—
9. Single parent — 1 child (0-6) — resident	5 496	342	343
10. Single parent — 1 child (0-6) — non-resident	6 144	342	343
11. Single parent — 1 child (6-11)	6 144	342	343
12. Single parent — 1 child (12-17)	6 336	342	343
13. Single parent — 2 children (0-6)	6 960	684	686
14. Single parent — 2 children (6-11)	7 140	684	686
15. Single parent — 2 children (12-17)	7 308	684	686
16. Two parents — 1 child (0-6)	6 180	342	343
17. Two parents — 1 child (6-11)	6 180	342	343
18. Two parents — 1 child (12-17)	6 300	342	343
19. Two parents — 2 children (0-6)	6 828	684	686
20. Two parents — 2 children (6-11)	6 948	684	686
21. Two parents — 2 children (12-17)	7 032	684	686

[1] Scales in force on January 1, 1983. Based on the scales of the *Family Benefits Act* for single-parent families and on those of the *General Welfare Assistance Act* for the other households. To compute the rent supplement, we have taken the average cost of the dwelling (rent + heating + electricity) declared by social aid beneficiaries in Québec in June 1983 which corresponds to the various types of household, i.e. 147 $ per month for single persons under 30, 172 $ for single persons between the ages of 30 and 64, 191 $ for couples under 30, 197 $ for couples between the age of 30 and 64, 211 $ for single-parent households with 1 child, 223 $ for single-parent households with 2 children, 212 $ for two-parent households with 1 child and 222 $ for two-parent households with 2 children. In the case of households living with a parent, we have taken the rates of board and lodging which apply in non-profit situations.

* Residing with a parent or child. It is assumed that these persons do not receive a property tax refund. All other households are deemed not to be residing with a parent or child.

Table III.5 (continued)

Elements of the basic minimum income in Ontario and comparison with total assistance in Québec for certain households receiving social aid whose head is able to work
(1983)

	Elements of Ontario basic minimum income ($) (cont'd.)							
	Provincial credits							
Type of household	**Property tax²**	**Sales tax allowance**	**Heating**	**Basic minimum income**	**Social assistance special needs in Ontario³**	**Total assistance Ontario**	**Total assistance Québec**	**Ratio Québec/ Ontario**
1.	—	38	—	38	0	38	1 903	50,08
2.	185	38	20	3 519	120	3 639	1 941	0,53
3.	—	38	—	2 762	120	2 882	1 903	0,66
4.	185	38	20	3 519	120	3 639	1 941	0,53
5.	—	38	—	2 762	120	2 882	4 019	1,39
6.	205	38	20	3 767	120	3 887	5 156	1,33
7.	210	71	20	5 677	240	5 917	3 950	0,67
8.	214	71	20	5 729	240	5 969	8 315	1,39
9.	—	71	—	6 252	320	6 572	6 656	1,01
10.	220	71	20	7 140	320	7 460	7 837	1,05
11.	220	71	20	7 140	362	7 502	7 600	1,01
12.	220	71	20	7 332	400	7 732	7 715	1,00
13.	223	78	20	8 651	480	9 131	9 422	1,03
14.	224	78	20	8 832	564	9 396	9 026	0,96
15.	225	78	20	9 001	640	9 641	9 219	0,96
16.	220	78	20	7 183	360	7 543	9 822	1,30
17.	220	78	20	7 183	402	7 585	9 628	1,27
18.	221	78	20	7 304	440	7 744	9 736	1,26
19.	223	85	20	8 526	480	9 006	11 380	1,26
20.	224	85	20	8 647	564	9 211	11 008	1,20
21.	225	85	20	8 732	640	9 372	11 195	1,19

2. Based on housing costs set out in note 1.

3. Based on an estimate of total expenditure for special needs for beneficiaries as a whole, i.e. an estimated amount of 120 $ per annum per beneficiary under the *General Welfare Assistance Act* and 160 $ per annum per beneficiary under the *Family Benefits Act*. Also includes educational expenses of 42 $ per year for a child aged 6-11 and 80 $ per year for a child aged 12-17.

whose head is between 30 and 64, total assistance being about 39% more in Québec than in Ontario.

In the case of single-parent families, the two systems are equivalent, with almost identical levels of total assistance in spite of differences in the elements of the two systems. The Ontario system appears to be more generous for large families and those with older children. In the case of two-parent families, the Québec system seems more generous than the Ontario system for all types of households. The difference decreases for larger families and for those with older children.

As a general conclusion, it may be said that the Québec social aid system for persons able to work usually pays benefits that are higher than those of Ontario, being less generous for single persons and childless couples 21 to 29, but more generous for single persons aged 18-20 living with their parents, and for single persons and childless couples between the ages of 30 and 64 who represent almost 40% of social aid recipients in Québec. It is equivalent to the Ontario system in the case of single-parent families and more generous in the case of two-parent families. Generally speaking, Québec's social aid benefits are higher for the largest groups of beneficiaries. In the case of households whose head alone is able to work, a little over $150 million could be saved if the Ontario standards were applied in Québec.

3.2.4 Comparison with the level of essential needs

As we have seen, the guarantee of a basic minimum income represents a social objective of primary importance since it consists in ensuring that any person or household has sufficent income to satisfy what are considered to be its essential needs, that is, all the needs required to preserve health and human dignity. Obviously, there is no absolute norm for this basic minimum income or for what is generally known as the poverty line. According to section 5 of the *Social Aid Act*, "ordinary needs are food, clothing, household and personal requirements and any other costs relating to the habitation of a house or lodging." This definition is wide open to interpretation. Furthermore, studies on the question run the risk of being arbitrary or subjective.

To avoid such pitfalls, reference may be made to the consumer expenditures of households for whom employment is the main source of income. Even then, what employment income should be chosen? Should the level of essential needs, which will be guaranteed by the State for all households, be based on the expenditures for ordinary needs of workers earning the average industrial wage or on that of the lowest paid workers on the labour market? The choice of yardstick and the goods insured will inevitably have an impact on the incentive to work. For example, if all households were guaranteed sufficient resources to cover ordinary expenditures of workers earning the average industrial wage, this would probably encourage workers who earned less to be dependent on the State to enhance their well-being.

We therefore chose the average amount of expenditures by low-income households, that is, those whose income in 1983 was under $13 700, and was earned mainly from employment. Incomes under $13 700 are those of heads of household or spouses working full-time who are in the first **income decile** (10%)[16]. It is the level of expenditures by households with less than this income, earned primarily on the labour market, which serves as a guideline to evaluate the coverage of essential needs by income security programs which act to guarantee a basic minimum income. For purposes of comparison, however, Table III.6 shows the average level of expenditures of all households whose income, earned primarily on the labour market, is lower than the average industrial wage of $21 500.

Once the group of households which would serve as a guideline was chosen, the expenditures to be considered as essential had to be determined. Certain types of expenses were first of all excluded from the workers' expenditures, either because these were special needs covered under social aid (prescription drugs, dental and optometric care), or because they were job-related costs (like the use of an automobile, child care costs, union dues) or were expenses not considered to be essential (restaurant,[17] tobacco, and alcoholic beverages). Among the expenses that were considered, three categories were defined:

- expenditures for essential short-term needs, i.e. current expenditure requiring at least one monthly payment. These items include food, housing, communications, household services and personal services;

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[16] The first decile of income was derived by projecting Statistics Canada's 1978 survey of family spending to 1983.

[17] Restaurant expenses excluded represented that portion which exceeded the basic cost of the food.

- expenditures for essential needs of a more long-term nature, i.e. those not requiring regular payments on a monthly basis. These include clothing and furniture;
- expenditures for important but non essential needs such as public transport, recreation and reading.

Table III.6 shows, according to size of household, the average annual expenditures for each of these categories of needs.

The expenditures of low-income households on these three categories of needs cannot be compared directly with the basic minimum income guaranteed in Québec, for two reasons. First, the household considered in the transfer system consists of parents and children; this is not quite the same as a household as defined by the Statistics Canada survey and including any group of persons living in the same home. Second, a child of 18 or over who is no longer studying is not considered, for transfer program purposes, to be a member of the household formed by his parents, even if he is living with them.

On the other hand, the monthly benefits paid to a family will be reduced by $85 if the family lives with a person who is a relative. It follows that the administration of transfer programs which act to guarantee a basic minimum income is not concerned with whether a person actually lives alone or shares quarters with other persons unless they are related to him. In fact, it is assumed that this person lives alone and his needs are recognized accordingly. In view of the economies of scale possible when sharing independent living quarters with other persons, the government assures a

Table III.6

Annual expenditures for basic needs by size of household reference groups
1983
(in dollars)

	One-person household earning less than		**Two-person household earning less than**		**Three-person household earning less than**		**Household with four members or more earning less than**	
	13 700 $	**21 000 $**	**13 700 $**	**21 000 $**	**13 700 $**	**21 000 $**	**13 700 $**	**21 000 $**
Essential short-term needs								
Food	1 524	1 776	2 604	3 036	3 360	3 924	528	624
Housing	1 992	2 196	2 736	3 012	3 096	3 408	360	396
Communications	144	144	168	168	168	180	—	—
Household services	240	264	372	408	456	504	72	84
Personal care	180	204	288	312	336	372	48	48
Total: short-term needs	4 080	4 584	6 168	6 936	7 416	8 388	1 008	1 152
Essential long-term needs								
Clothing	324	336	768	792	876	900	—	—
Furniture	516	528	924	960	1 164	1 200	192	192
Total: essential needs	4 920	5 448	7 860	8 688	9 456	10 488	1 200	1 344
Non essential needs								
Public transport	228	276	372	456	420	504	—	—
Recreation	336	312	420	384	444	420	24	36
Reading	120	132	132	144	132	144	—	—
Total: essential and non essential needs	5 604	6 168	8 784	9 672	10 452	11 556	1 224	1 380

Source: *Ministère de la Main-d'oeuvre et de la sécurité du revenu.*

higher coverage of basic needs for persons who share housing with those who are not related than for persons who really live alone or with someone who is related. This is expensive for the government since it is estimated that only 30% of single persons (unmarried, divorced, widowed, etc.) under 65 actually live alone in independent housing; the other 70% share or live in a rooming house.

In considering the essential needs of a single person, then, we must determine what type of lifestyle is viewed as essential: to live alone, to share with one other person or with two persons, and so on. In Table III.7, two possibilities are envisaged:

- The essential needs of a single person are those of low-income households consisting of a single person;
- They are equal to one-half the needs of a low-income household consisting of two persons with at least one person working full time.

These two assumptions seem realistic when account is taken of the fact that the average number of persons per household is 3, the third person usually being a child.

The second difficulty in comparing the guaranteed income with essential needs involves the level of essential needs to be attributed to children. The Statistics Canada survey does not allow us to distinguish between households made up of adults and those with children. It may reasonably be assumed that the households consist mainly of an adult when there is a single person, two adults when there are two, two adults and one child when there are three, and two adults and two children when there are four. It is logical then to attribute to the first child in a two-parent family the needs granted to the third person in the workers' households surveyed, and to each of the following children the needs recognized for a fourth member of such households.

On the other hand, the additional expenses for a first child in a single-parent family are not measured specifically. They may be equated with those of the first child or the second adult in a two-parent family. In the second case, it is assumed that the essential needs of a child are no different from those of an adult, while in the first it is postulated that a single-parent family can achieve the same economies of scale as a two-parent family. Reality probably lies somewhere in between. The essential needs of such single-parent families are therefore shown in Table III.7 in two ways: either the essential needs attributable to a first child are the same as those of the first child in a two-parent family (third person), or they equal those attributable to the second adult in such a family.

In Table III.7, the method just described is applied to nine typical households in order to compare the income guaranteed by the State with the expenses for essential needs inventoried among low-income households. The conclusion is that the basic minimum income guaranteed by the transfer programs is higher than the norm determined by the consumption expenditures for the coverage of what are considered to be the **short-term essential needs** of households earning less than $13 700, whose income is mainly derived from employment.

If we include in the norm consumption expenditures of these households for the coverage of their **long-term essential needs** such as clothing and furniture, the basic minimum income under the transfer system is virtually equal to the consumption expenditures of low-income households for all their essential needs.

If, however, some **important but non essential needs** such as public transport, recreation and reading are included in the level of essential needs, it will be seen that the basic minimum income corresponds to about 90% of all the consumption expenditures of low-income households for all these types of needs.

The transfer system thus seems to consider that even if they are able to work, these persons will remain on social aid long enough to incur expenses required to meet long-term essential needs. The only exceptions remain single persons and childless couples under 30 years of age.

It is interesting to note, however, that in Ontario, the basic minimum income is fairly close to the amount required by two-parent families and persons in the 30-64 age group. For example, under Ontario's transfer system, a single person 30-64 receives $3 767 whereas the essential short-term needs for a single person amount to $4 080; in Ontario, a family with two children between 6 and 11 receives $8 647, compared to $10 467 under Québec's system and to the amount required to cover essential short-term needs, $8 424.

For single-parent families, if the level of essential needs for a first child is equated with that of the second adult in a household, the rate of coverage of their essential needs is equivalent to that of other groups of persons over 30. If the level of essential needs is compared, instead, with that of

Table III.7

Comparison between the basic minimum income and the level of expenditures of low and average-income households using different assumptions for single persons and single-parent families (1983)

(in dollars)

Type of household	**(A) Basic minimum income**[1]	**(B) Essential short-term needs**[2]	**Coverage rate (A)/(B) (%)**	**(C) Essential short-term and long-term needs**[3]	**Coverage rate (A)/(C) (%)**	**(D) Essential and non-essential needs**[4]	**Coverage rate (A)/(D) (%)**
Single persons							
A. Needs equal half those of a two-person household							
• Single person under 30	1 796	3 084	58	3 930	46	4 392	41
• Single person 30-64	4 932	3 084	160	3 930	126	4 392	112
B. Needs equal those of a household consisting of a single person							
• Single person under 30	1 796	4 080	44	4 920	36	5 604	32
• Single person 30-64	4 932	4 080	121	4 920	100	5 604	88
Couples							
• Childless couple — 2 spouses under 30	3 599	6 168	58	7 860	46	8 784	41
• Childless couple — 2 spouses 30-64	7 821	6 168	127	7 860	100	8 784	89
• Two-parent — 1 child (0-6)	9 393	7 416	127	9 456	99	10 452	90
• Two-parent — 2 children (0-6)	10 906	8 424	129	10 656	102	11 676	93
• Two-parent — 2 children (6-11)	10 467	8 424	124	10 656	98	11 676	90
Single-parent family							
A. The first child has the same essential needs as the first child in a two-parent family							
• Single-parent — 1 child (0-6)	7 643	5 328	143	6 516	117	7 272	105
• Single-parent — 2 children (0-6)	9 193	6 336	145	7 716	119	8 496	108
B. The first child has the same essential needs as a second adult in a household							
• Single-parent — 1 child (0-6)	7 643	6 168	124	7 860	97	8 784	87
• Single-parent — 2 children (0-6)	9 193	7 416	124	9 456	97	10 458	88

1. See Table III.2. Special needs under social aid have been omitted from the basic minimum income. Single persons and single-parent families are considered as non-resident persons.

2. Needs include food, housing (including heating and electricity), communications (telephone, mail), household services (cleaning products, paper articles and food wrapping, other household items) and personal care (personal care services, toilet goods, personal care appliances).

3. To essential short-term needs must be added clothing (clothes, shoes, clothing accessories) and furnishings and accessories (furniture, household appliances, kitchen and tableware, household linen and plastic items, tools, decorative articles, etc.).

4. To essential short and long-term needs must be added public transport, recreation (admission tickets, recreational material) and reading matter (newspapers, books, magazines).

the first child in a two-parent family, the rate of coverage runs between 15 and 20 percentage points higher than for the essential needs of other families. The transfer system, it seems, has recognized that the essential needs of the first child in a single-parent family are equivalent to those of the second adult in a family.

In conclusion, it should be noted that apart from single persons and childless couples under 30, the basic minimum income guaranteed by the State for persons able to work is high enough to cover more than the total consumption expenditures of low-income households for the coverage of their essential short-term needs. However, it is about 90% of all expenditures for consumption for these households for the coverage of all their essential and non essential needs. Moreover, the basic minimum income guaranteed in Ontario is generally lower than in Québec and comes closer to matching essential short-term needs.

3.2.5 Comparison with the level of essential needs recognized by the tax system

The transfer system enables individuals and families whose income is insufficient to meet their essential needs. The tax system ought to avoid taxing the income necessary to cover the essential needs of the taxpayer and his dependents. That is the role of personal exemptions. The various tax credits and reductions can fulfil the same role since they affect the amount of income which is not taxable.

The integration of the tax and transfer systems requires, in the first place, exemption from tax of an amount of income which will at least provide the generally recognized level of essential necessities. As Table III.8 shows, the Québec tax system

Table III.8

Comparison of essential needs recognized under the Québec income tax system and under the transfer system
1983
(in dollars)

	Income guaranteed under the transfer system[1]	Level of income exempted from income tax in Québec[2]
1. Single person between 18 and 29	1 796	5 130
2. Single person between 30 and 64	4 932	5 130
3. Childless couple between 30 and 64		
• one income-earner	7 821	8 900
• two income-earners	7 821	10 260
4. Single-parent family with one child under six	7 643	12 200
5. Two-parent family with two children under six		
• one income-earner	10 906	15 069
• two income-earners	10 906	16 464
6. Two-parent family with two children between 6 and 11		
• one income-earner	10 467	11 104
• two income-earners	10 467	15 584
7. Couple 65 or over (neither spouse working)	11 119	14 460

1. Includes social aid, Québec and federal family allowances, availability allowance, property tax refund, Old Age Security Pension and Guaranteed Income Supplement.
2. Includes personal exemptions, general 100 $ deduction, deduction for child care expenses, exempt federal family allowances, Québec family and availability allowances expressed as exemptions.

meets that criterion. In all the cases considered, income exempted from taxes[18] exceeds the level of basic minimum income assured under transfer system.

However, the extent of the disparity between the level of essential needs as recognized under the tax system and as guaranteed under the transfer system varies appreciably from one category of household to another, rising from $198 for single taxpayers between 30 and 64 to $5 558 for two-parent families with two children under 6, in which both spouses work. The discrepancy is also very high for single people under 30, for single-parent families and for other families in which both spouses work. With respect to single taxpayers under 30, this spread results from the fact that the transfer system does not entirely meet their essential needs. For single-parent families, the reason lies in the combination of the equivalent to married exemption, availability allowance and child tax credit. In the case of two-parent families, the explanation is to be found first in the treatment of children under six. A further point to note is that households with two incomes receive more favourable treatment than those with one income only insofar as the tax system is concerned. There are two reasons for this: first, employment-related expenses are recognized, second and more importantly, the basic exemption is more substantial than the exemption for a married person.

A positive discrepancy between the amount of income exempted from tax and the basic minimum income assured under the transfer system is not unreasonable in itself. The principle adopted is not to tax income used to secure essential needs. That is not to say that income immediately above that level must be taxed. On the contrary, it is even preferable to ensure a certain transition zone within which benefits under the transfer system are gradually reduced, free from tax, to avoid a situation where workers pay to the State in taxes and reduced benefits almost the whole of the additional income received when they return to the labour market. When taxes are imposed on income just above the basic minimum guaranteed income, the marginal tax rates applied are added to the marginal rate of reduction of transfers, thus adversely affecting the incentive to work. In this paper the sum of these two marginal rates is included in the *implicit marginal tax rate*. In addition, a problem of equity emerges from the fact that the differential between the basic minimum income guaranteed by the transfer system and the income to which tax starts to apply varies greatly from one household to another.

3.2.6 Compensation for family responsibilities

The basic minimum income guaranteed by the State also helps to meet child-related expenses. As we saw in Chapter II, several mechanisms are in place for this very purpose.

For familes whose financial resources are insufficient, compensation for family responsibilities should normally cover those essential needs of children which cannot be met by the family's resources. The social aid program therefore provides additional benefits to families whose family allowance and tax credits are not high enough. As for families whose income is sufficient, it is not obvious that the State should provide assistance to meet the expenses associated with children. On the other hand, it is clear that the tax system should not tax the income necessary to cover the essential needs for children.

The essential needs recognized differ in the tax and transfer systems, and they vary considerably according to the age of the children and the organization of the family. As shown in Table III.9, the tax system recognizes distinctly less ($487) for essential needs of a child between 6 and 11 than the social aid program ($1 305). However, if this child lives in a single-parent family whose head is over 30, his recognized essential needs will be $4 257 in the tax system and $2 442 in social aid. If the head of the family, single-parent or two parent, is under 30, the State will pay $5 578 ($5 527 for a two parent family) more than for single persons under 30 who have no children; these persons receive benefits according to a reduced scale.

In the tax system, the needs of children 6 to 15 are poorly covered for families with two married parents, while those of children under 6 and 16-17 are better covered because of the availability allowance and the exemption for children 16 and 17.

For larger families, the differences between the recognized essential needs tends to dwindle as the number of children goes up. While the amount of benefits paid is substantially equivalent, $1 305, $1 341 and $1 336 respectively for the first, sec-

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[18] Income exempted from taxes is determined first of all by the amount of personal exemptions, as well as the existence of tax credits and non-taxable allowances, such as the availability allowance, family allowance, spouse's allowance or guaranteed income supplement.

Table III.9

Comparison of essential needs of low-income workers for dependent children with their recognized essential needs under the tax system and the transfer system by size of family
1983
(in dollars)

	Essential needs recognized in the tax system[1]	
Size of family	**Two-parent families (married)**	**Single-parent families or two-parent families (de facto spouses)**
Families with one child		
▪ under 6	1 425	5 195
▪ 6 to 11	487	4 257
▪ 12 to 15	573	4 343
▪ 16 and 17	1 343	4 343
Families with two children		
▪ under 6	2 752	6 522
▪ 6 to 11	1 190	4 960
▪ 12 to 15	1 362	5 131
▪ 16 and 17	2 902	5 901
Families with three children		
▪ under 6	4 329	8 099
▪ 6 to 11	2 455	6 225
▪ 12 to 15	2 712	6 482
▪ 16 and 17	5 022	8 022

1. Basic needs recognized in the Québec tax system include the exemption of federal family allowances, the exemption for children of 16 and 17 and family and availability allowances converted into exemptions at the maximum marginal rate.

ond and third child between 6 and 11 in two-parent families receiving social aid, recognized needs increase with the rank of the child in the tax system: $487, $703 and $1 265 respectively. The graduated family allowance scale with amounts increasing with the child's position is partially compensated for by lower increases in the social aid benefits, whereas it has its full effect in the tax system.

In both the tax and transfer systems, the essential needs recognized for children in single-parent families are distinctly higher than in two-parent families. The same is true for two parent families who are not legally married and who are recognized as single-parent families in the tax system. Essential needs for two children between 6 and 11 as recognized by the tax system will be $1 190 for a married two-parent family compared to $4 960 for a single-parent family or for a family in which both de facto spouses earn income. This large differential stems from the fact that single-parent families or de facto spouses can claim the equivalent to a married person's exemption with respect to the first child; this exemption is limited to a single claim per independent dwelling.

Table III.9 (continued)

Comparison [illegible] essential needs of low-income workers for dependent children with their recognized essential needs under the tax system and the transfer system by size of family
1983
(in dollars)

Supplementary benefits for social aid[2] recipients because of children				**Average additional expenditures for essential needs[3] by low-income workers (under 13 700 $)**		
Families 30 to 64		**Families under 30**				
Two-parent	**Single-parent**	**Two-parent**	**Single-parent**	**Short-term essential needs**	**Short and long-term essential needs**	**Essential and non-essential needs**
				1 248	1 596	1 668
1 572	2 711	5 794	5 847			
1 305	2 442	5 527	5 578			
1 391	2 529	5 613	5 665			
1 391	2 529	5 613	5 665			
				2 256	2 796	2 892
3 085	4 261	7 307	7 397			
2 646	3 827	6 868	6 963			
2 820	4 001	7 042	7 137			
2 820	4 001	7 042	7 137			
				3 264	3 996	4 116
4 486	5 664	8 708	8 800			
3 982	5 162	8 204	8 298			
4 244	5 421	8 466	8 557			
4 244	5 421	8 466	8 557			

2. Supplementary income is calculated for social aid recipients not residing with a relative.

3. These needs stem from average additional expenditures for a third person in the household, associated with those for a first child, and additional expenditures for the fourth and following persons in a household, associated with those for a second or later child.

These levels of transfers associated with the presence of children in families that receive social aid are higher for two-parent families than the average expenditures of low-income households for the short-term essential needs of a child. They are closer to the level of short and long-term essential needs. For larger families and those with children under 6, on average they reach what these households spend for the essential and important but nonessential needs of their children. These results stem from the fact that the transfer system takes little account of the economies of scale which families enjoy.

3.2.7 The question of special needs

The special needs recognized by the social aid program apply to situations which do not normally recur from one month to the next or from one beneficiary to another. The aim of this assistance is primarily to preserve good health, compensate for loss of household goods because of fire or other hazards and encourage employment. All social aid recipients are reimbursed for special needs. Of these, free drugs and dental services are those for which an increasing rise in costs is noted. According to the estimate presented at the beginning of this chapter, special needs for a two-parent family with two children between 6 and 11 came to an average of over $500 in 1983, about 6% of the ordinary social aid benefits paid to these families.

Legal aid is also a recognized special need. Its aim is to cover any costs related to the administration of justice (professional services and court costs) incurred by persons whose weekly income does not exceed certain limits. For instance, these limits are $170 a week for a single person, and $215 for a family of three.

The existence of these special needs in an adequate transfer system obviously cannot be questioned. Nonetheless, the consequences are sometimes disturbing. For those who receive benefits related to such special needs there is little incentive to come off social aid or increase their income, thus incurring the loss of governmental compensation for such needs.

3.2.8 The basic minimum income for students

Even though student aid programs are not being exhaustively analysed in this *White Paper*, it is nevertheless important to examine its elements if we wish to judge the treatment by the transfer system of young persons who are not students. The transfer system should not discourage young people from continuing with post-secondary studies. The transfers they receive as well as their needs are very hard to compare with those of the rest of the population. First, in addition to essential needs, students have further requirements that are related to their studies: tuition fees, cost of books, transportation, etc. Moreover, the problem of essential needs for students is necessarily a long-term matter, since their post-secondary studies are spread over a number of years. Finally, assistance to students includes, in addition to grants, loans on which the State pays the interest until their studies are completed. Since the present value of a current dollar is greater than that of a dollar earned after the completion of studies, the students' contribution is also decreased. These loans cannot be compared with ordinary benefits since they will vary in terms of the length of studies and the level of interest rates.

On the other hand, the student assistance program (loans and grants) is not simply a transfer program. Assistance to students is primarily part of the education policy and intended to help people realize the investment in human capital constituted by post-secondary studies. The problems of coordinating the social aid program with the student assistance program will be dealt with in section 3.6.1.7.

3.2.9 The basic minimum income for the elderly

In the case of persons aged 65 or over, it is also difficult to compare their level of basic minimum income and essential needs with those of persons between 18 and 64, even if the comparison may be useful. Their basic minimum income will in fact depend on their previous situation on the labour market (level of earnings and number of years of contribution to the Québec Pension Plan). The level of essential needs of persons 65 or over cannot be equated with that of younger persons able to work, for once permanently out of the labour market their position differs.

Table III.10 compares the guaranteed basic minimum income for elderly single persons and couples, according to whether these persons have or have not contributed to the Québec Pension Plan, with the income guaranteed for persons under 65. (The example given is calculated on the basis of earnings equal to the average industrial wage.)

The basic minimum income guaranteed to persons aged 65 or over who have never contributed to the QPP is 29% and 42% higher respectively than that guaranteed for single and married persons between 30 and 64. Note that the data are those for 1983 and that the guaranteed income supplement will be increased by $50 monthly in 1984, thus further widening the gap referred to here.

The level of basic minimum income guaranteed for elderly single persons corresponds to the average essential and non essential needs satisfied by single persons working full time with an income under $21 000; for elderly couples 65 or over, the guaranteed income is 15% higher than that provided to cover the essential and non essential needs of couples under 65 who are also earning less than $21 000 (see Table III.6).

Furthermore, if one of the spouses earned income before his retirement equal to the average industrial wage, and accumulated in his pension plan retirement benefits of $4 142 a year, his guaranteed basic minimum income will be only some $2 000 higher than that of a person who has not participated in the labour market. At these income levels, each additional dollar of QPP benefits entails a reduction of $0.50 in the guaranteed income supplement.

We may conclude that the level of basic minimum income guaranteed by government for the elderly is definitely higher than for persons under 65. This difference can be explained first by the fact that the Old Age Security System is administered on a Canada-wide basis and may not be compatible with the benefits paid in each province for under-65s. Also the level of basic minimum income for persons 65 or over may be determined without reference to what the labour market offers, since maintaining the incentive to work is no longer an issue.

It might also be thought that essential needs are greater for elderly persons. Obviously, all health-related needs (drugs, medical and hospital expenses, etc.) are greater for the elderly. However, these needs are almost all covered by the State.

The elderly also have a number of needs related to their degree of autonomy. Extended care hospital centres and homes for the elderly have a role to play here. However, these programs are not analysed in this *White Paper*.

Because of the existence of a high level of basic minimum income and that of the Old Age Security Pension (which is universal), it may be considered that although the special programs offered by Québec, i.e. free drugs, ambulance services and housing assistance through the LOGIRENTE program, are absolutely essential in certain cases, they are somewhat generous in others.

3.2.10 Indexation of components of the basic minimum income

Indexation of benefits making up the basic minimum income is more complete than in the case of income tax. While most benefits are indexed, the methods used differ from one program to another. As shown in the Table III.11, a number of programs are subject to statutory indexing every quarter (social aid, Old Age Security Pension, guaranteed income supplement, spouse's allowance), others to statutory indexing every year (federal and Québec family allowance, federal child tax credit); since they are usually tied to specific needs that grow along with inflation, their indexation is not justified unless they involve ceilings or other conditions of this kind.

Notwithstanding their differences, the indexation methods applicable to the various transfer programs have the common characteristic of being based on the consumer price index. In a period of economic slowdown, the use of such an index may have an adverse effect. When the growth of income in the economy as a whole is lower than the rise in the general price level, in other words, when national income declines in real terms, indexation of transfers to inflation produces a transfer of income to recipients of these benefits. Their income will rise faster than that of the rest of the population. In such a situation this automatic indexing changes the relationship which should normally exist between the transfer system and the labour market, with the effect of reducing the incentive to work.

Table III.10

Comparison of basic minimum income for persons 65 or over according to their previous situation on the labour market
1983
(in dollars)

	Persons 65 or over					**Persons 30 to 64**
	Old Age Security Pension	**Guaranteed income supplement**	**Québec Pension Plan**	**Property tax refund**	**Total[1]**	**Total[1]**
1. Never contributed to QPP						
Single person	3 066	3 080	—	226	6 372	4 932
Couple	6 132	4 752	—	235	11 119	7 821
2. Contributed to QPP on earnings equal to average industrial wage						
Single person	3 066	1 016	4 142	261	8 485	
Couple	6 132	2 688	4 142	259	13 221	

1. Excluding special needs.

3.3 Participation in the Labour Market and Economic Efficiency

The tax and transfer systems may affect economic efficiency in many ways. In the present context, where income tax has become the principal form of collecting taxes from individuals, it seems that the tax system reduces economic efficiency and decreases the incentive to work because earning an income becomes less rewarding financially. This is particularly true when the transfer programs are also considered; a number of them tax income in their own fashion, since benefits are in inverse proportion to beneficiaries' income level.

As we have just seen, the standard of living guaranteed by transfer programs for persons 30 to 64 and families with children is similar to that of low-income workers for their short and long-term essential needs. This situation may seem likely to prove a considerable disincentive for social aid recipients to go out to work or for low-income earners to hold a job. Moreover, the tax system also raises problems of economic efficiency and work incentive for higher income workers. The purpose of this section is precisely to evaluate how taxation, when regarded as embracing the transfer system, can affect economic efficiency specifically by causing workers to change their participation in the labour market. The analysis will begin by describing the institutional framework of the mechanisms which can encourage or discourage participation in the labour market (except for those tax mechanisms that have already been described). The economic impact of these mechanisms will then be examined from a theoretical point of view initially, and then using various indicators.

3.3.1 The institutional context

3.3.1.1 Social aid and employment income

When a transfer program beneficiary earns employment income, his benefits are generally reduced in proportion to his earned income at what is known as a rate of transfer reduction; it is equivalent to a marginal tax rate on his income.

The social aid program has the highest marginal reduction rate, nearly 100% of every additional dollar of employment income. However, recipients are entitled to a deduction and to certain exemptions that enable them to earn a small amount of employment income without reducing their benefits. Social aid grants a 6% deduction for job

Table III.11

Indexation methods applied to various transfer programs

Program	Method of indexation	Period
Social aid	Statutory	Quarterly
Loans and scholarships	Discretionary	Yearly
Old Age Security Pension	Statutory	Quarterly
Guaranteed income supplement	Statutory	Quarterly
Spouse's allowance	Statutory	Quarterly
Family allowances		
• federal	Statutory	Yearly
• Québec	Statutory	Yearly
Federal child tax credit		
• amount of credit per child	Statutory	Yearly
• Family income cut-off point	Not indexed	—
Availability allowance	Not indexed	—

related expenses up to a maximum of $300 per annum which corresponds to earned income of $5 000. Furthermore, social aid accords a total exemption to the first $300 earned for a single person and the first $480 for a family, plus $60 for each dependent child. This characteristic of the social aid program gives greater encouragement to beneficiaries to earn occasional small amounts rather than take a regular full-time or part-time job (particularly if it requires them to file income tax returns).

As previously noted, another limitation in the social aid program, apart from the very high marginal reduction rates of benefits, is the fear of completely losing benefits for special needs when a full-time job paying more than social aid benefits is accepted.[19]

However, social aid has a provision for reducing benefits to a recipient if he refuses or leaves a job. For a first refusal the penalty is $50 per month for six months for each recipient. For a second refusal, the penalty is $100 for those over 30 and the full benefits for those under 30 (again for six months). The Québec and Canada manpower centres are responsible for detecting cases of refusal. In June 1983, only 1 328 persons were receiving reduced benefits. This means that probably very few refuse the jobs offered by the manpower centres or that very few jobs are offered. And perhaps the problem stems from the fact that recipients do not seek work as actively as they should.

3.3.1.2 The employment income supplement

Instituted in 1979, the employment income supplement program was designed primarily to encourage social aid recipients to return to or remain on the labour market. It is intended for all those earning less than certain minimum levels, except single persons under 30 and childless couples of the same age (for whom the reduced allowance constitutes the best work incentive).

The benefits paid are computed in two different ways, depending on whether earnings permit the maximum to be attained or not. Income from employment is thus supplemented at the rate of 25% until the benefits reach the maximum amount which normally corresponds to the income level that leads to cancellation of social aid benefits. The benefits are subsequently reduced as income increases.

The main effect of the supplement for social aid recipients is to reduce the marginal reduction rate of transfers to about 75%. It could thus be said that there is less disincentive to work. However, since the supplement is based on the previous year's income, its impact is only felt a year and a half later, which does not give much encouragement to social aid beneficiaries to come off welfare in the short run, for the first portion of their monthly employment income will be immediately taxed at almost 100%.

Furthermore, when a low-income worker comes off social aid, he is still entitled to the employment income supplement program. To prevent a sudden drop in the benefits paid by this program, there is a 33⅓% reduction rate of the benefits from the moment his employment income increases. Taking account of federal and Québec taxes, which may apply, the head of a family who receives benefits under this program and earns a gross income of $13 000 per annum will have to face implicit marginal tax rates of at least 62% if he receives a wage increase.

3.3.1.3 Employment income considered in other transfer programs

The situation will be even worse if a family receives benefits from other programs intended for low-income households such as low-rental housing and the allowance paid to parents with a child in a day care centre, which also have income-based reduction rates. If the family lives in low-rental housing, 25% will be added to the 62% rate for the rise in rent, and 26% for the reduction in child care assistance, which will bring the combined implicit marginal tax rate to more than 100% if there is an increase in earned income. The entire salary increase will go to the State.

Benefits under the student assistance program also decrease as the earnings of low and middle-income households with children studying at the post-secondary level go up. For example, a family with a child studying at the undergraduate level in a university and not living at home will have its benefits[20] from the plan reduced by an average of $25 for every $100 rise in family income between

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[19] Low-income earners may however be reimbursed for a portion of their recognized needs, if their resources are insufficient to cover their ordinary and special needs, with the exception of protheses, glasses and moving costs.

[20] In the case of loans, the benefit included is the value of the interest paid by the government.

$10 000 and $20 000 annually. This additional marginal rate is imposed on low-income workers who have children studying in post-secondary institutions on top of the reduction rates for the employment income supplement (between $10 000 and $13 000) and the federal and Québec tax rates.

Legal aid also constitutes a program of assistance for low-income clienteles access to which can be withdrawn when the beneficiary's wages go up. It will be in the interest of the head of a single-parent family who needs legal services to remain below the admissible limit of $185 a week if he does not want to lose free access to these services.

All these transfer programs uncoordinated with one another or with the tax system tend to confine beneficiaries to a poverty treadmill and encourage very few low-income workers to keep their jobs and to improve their lot. The increase in the net disposable income received by these workers is too low when a wage increase occurs and can only discourage them from increasing their availability for work.

3.3.1.4 Assistance for child care

In addition to the high marginal rates of reduction in transfers to families depending on the financial support of the State, the great cost of care for young children constitutes one of the main obstacles to entering the labour market for the head of a single-parent family and the second spouse in a two-parent family. In fact, the cost of day care may be over $3 000 in a year. These disincentives to work are encountered throughout the income scale for this type of household.

The financial aid program for child care helps lessen the effect of this barrier to entering the labour force for these low-income families. The aim of this program is to exempt parents, under certain conditions, from the obligation of paying a contribution for their children benefiting from a child care service in a day care centre, with an accredited family or at school.

The target clientele is any user of child care services whose net family income is below a certain fixed limit, based on the number of adults and children who are dependent on the applicant. This net family income corresponds to the total income of the applicant and his spouse for the previous year, less unemployment insurance and QPP contributions and the standard 3% employment expense deduction, including benefits and allowances received under the terms of Québec or other legislation.

The maximum daily amount of the allowance paid is $9 for a day care centre, $7 for care at school and $5 for care with a family. To benefit from this maximum, the net family income must not exceed $11 100, plus $600 for each child in the case of a single-parent family, and $12 300 plus $600 for each child in the case of a two-parent family. The amount of the daily allowance decreases by $0.50 for each $500 increase in the family income, to nothing for a child receiving full-time care when his parents have an income of about $20 000.

In 1983, the estimated number of Québec children under 12 whose mothers were working outside the home was 426 000 (Table III.11). According to the Office des services de garde à l'enfance, on March 31, 1983, there were 24 077 places in day care centres, 1 182 with families and 10 111 in schools.[21] In 1983-1984, about 50% of day care centre users benefited from at least partial exemption. The average daily amount per subsidized place was about $7.25. For day care with a family, the participation rate in 1983-1984 was 34% and the average amount about $5.10 per day. For child care at school, the participation rate was 3% and the average daily amount $4.30.

The financial aid program for child care thus provides assistance for at most 13 000 children from low-income families, less than 13% of the 103 000 children from single-parent families or two-parent families in which both spouses work, earning less than $20 000 (Table III.13). The range of the program is limited because it is restricted to methods of child care recognized by the Office des services de garde à l'enfance.

While the financial aid program for child care makes it easier for the head of a single-parent family and the second spouse in a two-parent family to enter the labour market when the family has a modest income, and is successful in placing the children in a licensed day care centre, it also has the effect of increasing the implicit marginal tax rates in the event of an increase in income. Between a net family income of $11 000 and one of $20 000, the head of a single-parent family working full time, with one young child, will have his government aid reduced by an amount equal to 26% of the increase in his net family income. Since the gradual withdrawal of this assistance is not harmonized with the tax system and other programs, its reduction will add to the tax to be paid on this extra income, thus increasing by that amount the deductions by government on that same increase in income.

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[21] Source: Office des services de garde à l'enfance, *Situation actuelle et perspectives de développement des services de garde à l'enfance au Québec, 1983-1988*, 3rd quarter, 1983

3.3.2 Economic impact of the tax and transfer systems

A number of factors have an impact on the labour supply: the level of economic activity, education, training, transfer programs, taxation, etc. The analysis in this section will be restricted to the effects of the tax and transfer systems on the labour supply.

Table III.12

Estimate of number of children receiving day care in Québec
1983

Age	**Number of children March 1983**	**Number of children whose mothers work**
		full and part-time
Under 2 years	177 900	not available
2-5 years	379 594	not available
Total under 6	557 494	228 750
		full-time
6-8 years	273 623	101 441
9-11 years	258 985	96 018
Total 6-11	532 608	197 459
Total under 12	1 090 102	426 209

Source: Office des services de garde à l'enfance, *Situation actuelle et perspectives de développement des services de garde à l'enfance au Québec 1983-1988*, 3rd quarter, 1983.

Table III.13

Distribution of number of children by income bracket of single-parent families where the head is working and two-parent families where both spouses are working

Income bracket[1] $	**Number of children 0-5 years of age**	**Number of children 6-11 years of age**	**Total**
0 — 5 000	4 600	2 000	6 600
5 000 — 8 000	8 000	5 200	13 200
8 000 — 11 000	9 400	7 300	16 700
11 000 — 14 000	10 300	7 900	18 200
14 000 — 17 000	12 800	10 300	23 100
17 000 — 20 000	14 500	10 200	24 700
Total	59 600	42 900	102 500

[1] The concept of income refers here to projected earned income for 1983, according to the demographic structure of 1981.

3.3.2.1 Theory

It is logical to think that people will stop working if their income is taxed too heavily or if the income they could earn is not sufficiently in excess of what they receive in transfers. Not many people are willing to work for nothing. However, this is a very general conclusion; it says nothing about the tax rate at which people are unwilling to work, nor does it shed any light on the circumstances under which people will choose part-time or casual work, etc. Many economists have studied this problem, hoping to find more specific conclusions. Their efforts have produced a systematic body of thought on the subject and have made it easier to measure the phenomenon. A brief review of these results is important at this stage.

— Impact on labour supply

The most important conclusion to come out of these studies is that the tax and transfer systems act on the labour supply in two distinct ways: the income effect and the substitution effect. The income effect arises from the impact of the change in the taxpayers's disposable income due to taxation on his willingness to work. When tax is levied, the taxpayer's income falls so that he must work more to maintain his standard of living. Conversely, when the taxpayer receives a transfer, his standard of living is raised automatically and there is less incentive to work to raise it even more. The income effect is thus related to the amount of the transfer or tax and does not depend on the type of tax levied or transfer received.

The substitution effect concerns only those taxes or transfers which reduce the net value of work, so that a worker normally earning $10 an hour actually earns only $6. Needless to say, motivation at $6 is not the same as at $10. The reason is that there is a change in the value of work relative to that of other activities from which an individual may choose, such as leisure, household work, barter activities, work in the underground economy or any other activity whose value is not taxable. It follows that the substitution effect is related to the change in the relative value of work, which can be measured by **implicit marginal tax rates**, or the increase in the net hourly wage. These two concepts are explained in Table III.14.

The tax and transfer systems generally have a negative subsitution effect. Of all the aspects of the system we have looked at so far, only two have a positive substitution effect on the labour supply; the work income supplement, which adds to the net value of work, and child care assistance, which produces the same result by helping to meet any child care expenses brought about by being at work. Every other aspect, except those not related to income, generates a negative substitution effect: taxes increase with income, while most transfers are reduced, so that the net value of work is diminished.

When the income effect is added to the substitution effect, the total impact is negative as far as transfers are concerned: the two effects work in the same direction. As for taxes, the result is not as clear, since they have a positive income effect, but a negative substitution effect. Most economic studies agree that the substitution effect is dominant over the income effect.

Moreover, it must be understood that only the substitution effect generates losses in well-being for society. The income effect creates no gap between the social value and the personal value of work and involves neither cost nor benefit to society.

It should also be noted that the continual increase in average and marginal tax rates over the past 20 years has had an effect on collective, as well as individual, labour supply. For example, marked sustitution effects which favour leisure might, in the long term, influence the desires of workers and pressure unions and governments to implement a shorter work week, longer vacations, more opportunities for leave without significant losses in wages, and a lower retirement age. Since such pressure may result from taxation and transfer policies, the influence of taxes on work may be even greater, in a collective context, than that calculated on the basis of individual reactions to high marginal tax rates.

— The disincentive to work resulting from domestic production and employment-related expenses

As in the case with individuals, the well-being of a household depends on the goods and services it may secure, and the leisure time it has available. Goods and services may be obtained on the market using employment income, or through domestic production. The same standard of living may be achieved by allocating time differently. When the implicit marginal tax rate is high, it may become profitable to devote part of one's time, not already allocated to leisure, to providing for one's needs, rather than working for an income which would make it possible to purchase the same goods and services. Neither leisure nor domestic production are taxable.

High implicit tax rates are not exclusive to high-income taxpayers. Let us take, for example, the case of a couple with two children; the main breadwinner's employment income is $12 000. His implicit marginal tax rate, including federal and Québec taxes, contributions to unemployment insurance and QPP, and the reduction of benefits from all transfers when his income increases, is about 60%. In this instance, time given over to domestic production is very important, as it is not taxable. With a marginal rate of 60%, this family head must increase his employment income by $2 500 before tax in order to pay $1 000 to have his house painted. Where the painter is subject to the same marginal tax rate, this work will bring him $400 net. If the taxpayer paints the house himself, the family will earn $1 000 net by doing work which would have brought an expert $400.

The labour supply may also accommodate itself to high implicit marginal tax rates by fostering exchanges of goods and services in kind. Bartering affects not only the activities of specialized and semi-specialized workers in such fields as maintenance, construction, electricity, plumbing, consulting, accounting, dental hygiene and so forth, but relations between employers and their employees as well. Heavy taxation favours the development of non-taxable fringe benefits, such as subsidized meals and travel, partly recreational meetings, and various types of organized activities, which are a form of remuneration in kind. Resorting to non-monetary remuneration is one way of escaping taxation. Heavy taxation may even favour the development of trades in which bartering is more prevalent.

The existence of substitution effects favouring domestic work and bartering do not imply that such activities are more widespread today than they were 25 years ago, although they are more in-

Table III.14

Method of calculating the interest in participating in the labour market
(Head of a two-parent family with two children under 6)
(in dollars)

	No employment income	**At the minimum wage 4,00 $/h**	**At an intermediate wage 7,50 $/h**	**At the average industrial wage 10,75 $/h**
Gross employment income for 2 000 hours	—	8 000	15 000	21 500
Social aid	8 807	2 087	—	—
Employment income supplement	—	685	119	—
Taxes[1]	2 134	1 868	445	−2 025
Disposable income	10 941	12 640	15 564	19 475
Net earnings (change in disposable income compared with no employment income)	—	1 699	4 623	8 534
NET HOURLY WAGE INCREASE (net earnings/2 000 hours)	—	0,85/h	2,31/h	4,27/h
Government's share of the increase in income: Gross hourly employment income less net hourly wage increase	—	3,15/h	5,19/h	6,48/h
IMPLICIT MARGINAL TAX RATE Government's share/gross hourly wage		79%	69%	60%

1. Taxes include:

• Income tax and contributions to QPP and unemployment insurance	—	−296	−1 688	−4 110
• Family allowances, availability allowance and child tax credit	1 929	1 929	1 929	1 929
• Property tax refund	205	235	204	156
• Total	2 134	1 868	445	−2 025

fluenced by tax considerations than by their comparative advantage in relation to similar activities on the official labour market. This situation leads to a reduction in taxed employment income for this part of the labour force, and a loss in economic efficiency, as it encourages the proliferation of non-taxed work, which bears no relationship to actual productivity.

Availability for work is also affected by expenses related to entry into the labour market. The unemployed set a minimum wage below which they are not interested in working. This reservation wage must at least equal social aid benefits. However, where transfers paid to the neediest are sufficient, income obtained by those who are not working will almost equal income earned by certain full-time workers. In Québec, the minimum wage for a single person or a childless couple, mainly those under 30, is substantially higher than social aid benefits. However, when they have children social aid becomes more advantageous, as benefits take into account the size of the family, for the two first children, where employment income does not. This situation creates a disincentive to work which the employment income supplement seeks to eliminate. Such allowances increase the net remuneration of these workers, and make the job market more attractive to them.

In addition to the basic minimum income guaranteed by the state, the reservation wage also takes into account employment expenses, and the lack of time for domestic production which, in certain cases, may considerably increase the minimum wage requirements of the unemployed.

Employment expenses include not only those related to travel, clothing and food, but child care expenses as well. Such expenses obviously increase with the number of pre-school children. Moreover, the lack of time to engage in domestic production and the necessity of paying to obtain the equivalent add to employment expenses. The problem is more acute among single-parent families, since they have less time available for domestic production than couples with or without children. The head of a single-parent family who works full time and cuts back on his leisure time as much as possible, lacks the time to undertake essential domestic production in the household; on the other hand, two-parent families in which only one spouse works may carry on domestic production and still have considerable leisure time. As the head of a single-parent family who decides to work must supplant an appreciable part of his domestic production with additional employment income, his reservation wage for entering the labour market will be higher than the wages of the second spouse in a two-parent family. A guaranteed minimum income program which takes into account employment expenses and is effective in encouraging the second spouse in a two-parent low-income family to join the labour force, therefore might not provide a sufficient incentive for the head of a single-parent family.

The possibility of engaging in domestic production and bartering therefore represents an appreciable constraint for the tax and transfer systems. With respect to employment expenses, it seems, increasingly, that the planners of the tax and transfer systems have not sufficiently taken them into account until now, primarily with regard to the costs related to earning income in the labour market incurred by the head of a single-parent family and by both spouses in a two-parent family.

— Other facets of the disincentive to work

The disincentive to work does not manifest itself uniquely through a reduction in working hours. Heavy taxation favours, for example, a drop in the intensity of work effort, and the search for less demanding occupations.

Similarly, heavy taxation discourages people from investing in human capital in the form of education or training. Such activities are usually undertaken with a view to improving one's life-long income potential. A highly progressive tax system will reduce the net return on the investment in human capital and, consequently, its attractiveness.

Another form of investment in human capital entails a worker's moving from an area lacking in remunerative employment to more promising regions. Higher taxes encourage them to work in other provinces. This effect will be greater if the unfavourable differential is considerable which, as we saw in Chapter II, is the case. And a more generous transfer system will reduce the attraction of regions with better employment prospects and may help attract more low-income earners and social aid recipients. It may also be expected that a strongly progressive tax and transfer systems will have a negative effect on inter-regional mobility, as the monetary gains resulting from the move are reduced, and the cost of mobility remains unchanged. In this case, workers are motivated not to seek the most remunerative employment; the effect is obviously to decrease economic efficiency.

High tax rates will also increase tax evasion and the search for tax privileges, and foster the substitution of activities in favour of those in which tax evasion is more frequent or easier. Not only does this type of substitution engender economic inefficiencies, but it also creates, in the short term at least, inequalities within society, as the ability and the desire to evade taxation varies among individuals.

One final aspect of the disincentive to work relates to the underground economy. Indeed heavy taxation may cause work in the underground economy to proliferate. As certain transfer programs have high marginal reduction rates, they make work for undeclared gain very lucrative. Work in the underground economy could thus be advantageous for social aid beneficiaries, especially since they have the leisure time required to participate in such activities. It has previously been noted that certain beneficiaries are very likely to have a reservation wage which is higher than what the job market is able to offer. While working for undeclared gain, the beneficiary continues to receive from the State an amount sufficient to provide for the family's essential needs; income from temporary employment enables the family to raise its standard of living above this basic level. Moreover, high marginal tax rates will also increase net employment income from the underground economy, in relation to work on the official job market.

We see then that the tax and transfer systems can affect the efficiency of the economy in several ways. It is important to try to measure the extent of the phenomenon. Two kinds of indicators will be used for this purpose. Those of the first group attempt to demonstrate the impact of the fiscal variables which affect the economy, while those in the second attempt to measure how the various economic agents respond to the system.

3.3.2.2 Fiscal indicators

The tax and transfer systems affect the incentive to work via the income and substitution effects. There is no need to show the extent of the income effect, since it can be measured by the amount of taxes paid or transfers received, both known quantities.

The substitution effect can be measured first of all using implicit marginal tax rates. An implicit marginal tax rate curve may be derived by calculating the marginal tax rate on each additional $1 000 of employment income (Graphs III.1 and III.2). With respect to single-parent families and couples with children with both spouses working in the labour market, these implicit marginal tax rates also include the increased child care expenses relative to the increase in employment income.

There are four major observations to be noted from these curves. First, the implicit marginal tax rate curve is generally quite high at low-income levels (90%). It then falls to a more reasonable level of about 35%-40% for taxpayers near the zero transfer threshold (income level at which transfers are reduced to nothing), before climbing gradually to 60% at high-income levels, the latter being the maximum marginal rate under the combined Québec and federal income tax systems.

Also, there is a significant variation in the progression of the implicit marginal tax rates and the magnitude of the variation is different for the various categories of taxpayers. This state of affairs can be attributed to the lack of coherence among the different transfer programs and the tax system. Third, the marginal rates for single-parent families with a young child, even when they are eligible for child care assistance, remain high (between 60% and 90%) up to the average industrial wage, at which point they assume a normal progression.

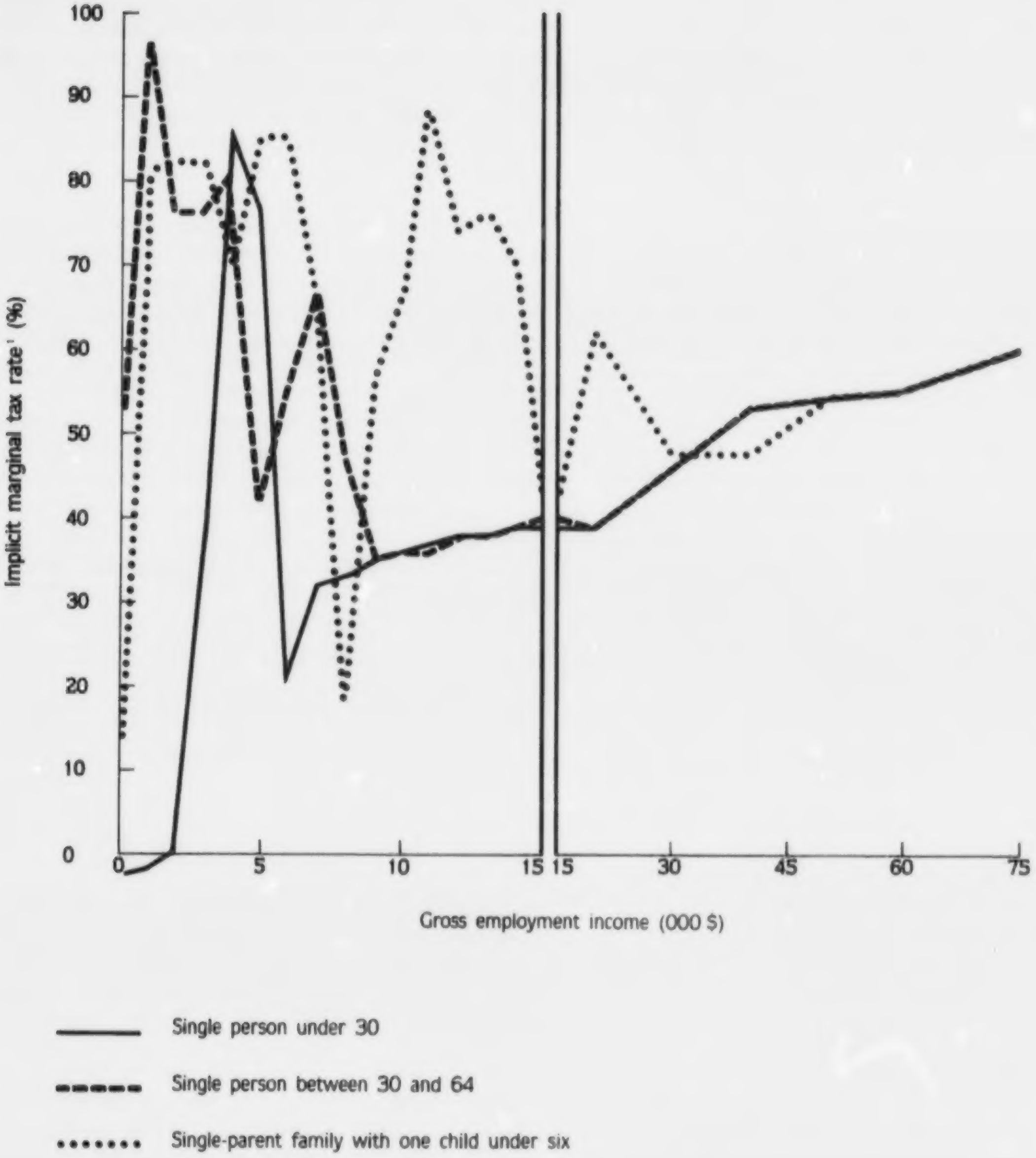
Finally, the tax system has frequently been criticized for being excessively progressive, on the grounds that marginal tax rates of between 50% and 60% on incomes in excess of $30 000 deprive society's most productive members of any incentive to work. However, Graphs III.1 and III.2 show that the most pronounced disincentives to work invariably occur at the low end of the income scale.

To give a better illustration of the degree of progressivity of the tax and transfer systems for the lowest-income taxpayers, we can calculate the increase in the net wage of a social aid recipient who enters the labour market.

Graph III.3 illustrates, for different gross hourly wage rates, the increase in the **net hourly wage** of a social aid recipient who takes a full-time job. It can be seen that for certain households, the net hourly wage increase for a worker earning the minimum wage ($4.00) is extremely low, less than $1.00 for a childless couple ($0.94) and a two-parent family with two young children ($0.85) or two children between 6 and 11 ($0.83), corresponding to implicit tax rates on entering the labour market of 76% and 79% respectively. The situation is not much better for single-parent families ($1.19) and single persons between 30 and 64 ($1.28).

Graph III.1

Implicit marginal tax rate on 1 000 $ additional employment income for a single person



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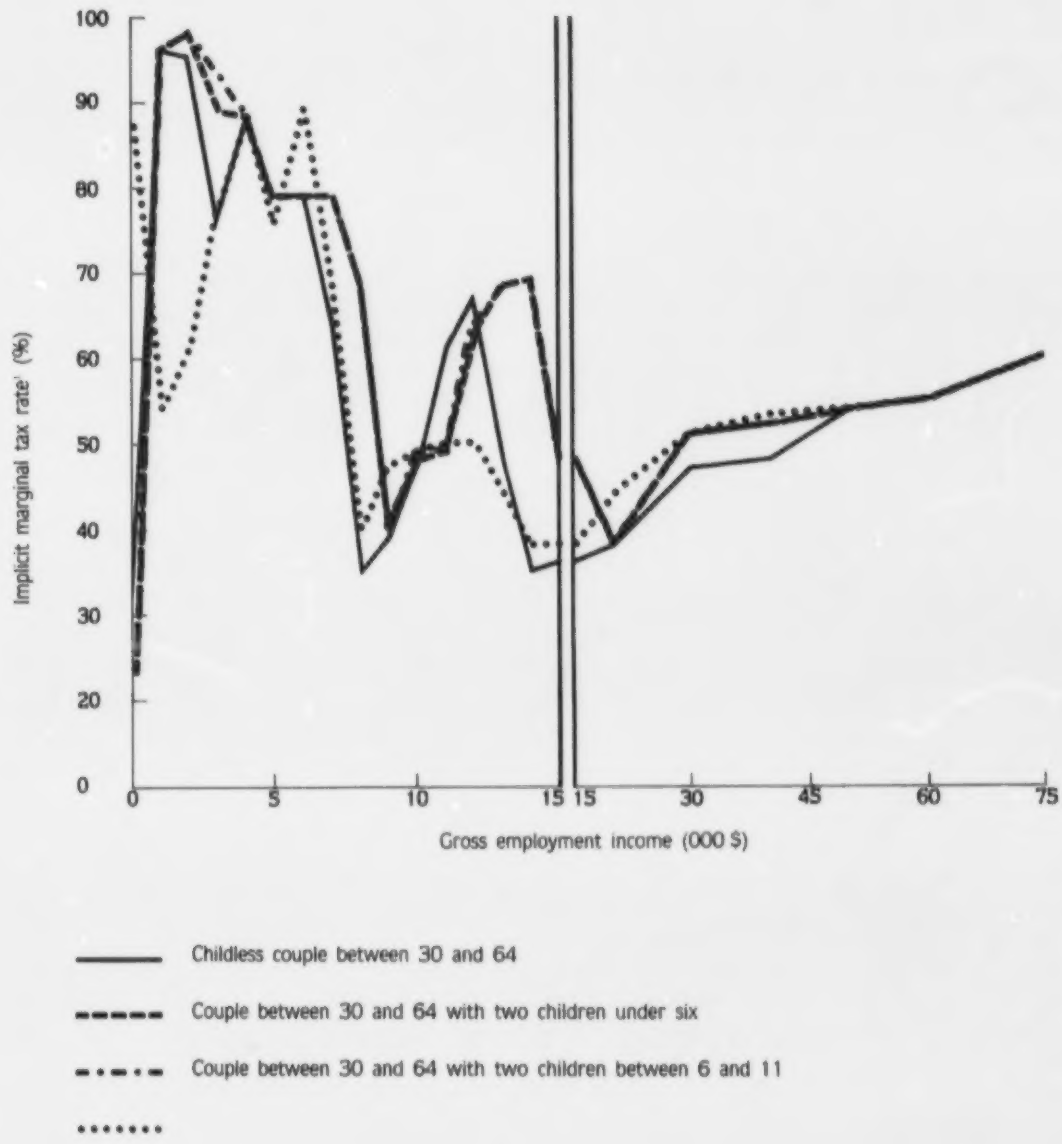
1. These implicit marginal rates include those on income tax, transfers and marginal rates on expenses related to child care, if any. It is assumed that households avail themselves of child care assistance if they are eligible to receive it.

Graph III.2

Implicit marginal tax rate on 1 000 $ additional employment income for couple



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1. These implicit marginal rates include those income tax, transfers and marginal rates on expenses related to child care, if any. It is assumed that households avail themselves of child care assistance if they are eligible to receive it.
2. Both spouses of the couple with two children 6 to 11 are on the labour market. The income of one spouse is fixed at 8 000 $, while the income of the other varies.

The reduced social aid benefits payable to single persons and childless couples under 30 reduce their average implicit marginal tax rates and leave them with a greater increase in net earnings. The same holds true, to a lesser extent, for the entry into the labour market of the second spouse in a family with children which receives child care assistance.

For some households, even entering the labour market at a higher gross wage may result in only a small increase in net income. For example, the head of a single-parent family who leaves social aid to accept a job at the average industrial wage ($10.75) will realize a net hourly wage increase of only $3.82. For a two-parent family with two children and a single breadwinner, the net hourly wage increase will be between $4.25 and $4.27, depending upon the age of the children.

For the head of a single-parent family as well as for the second spouse of a couple, the gain from entering the labour market, in the vast majority of cases, is much less than indicated in Graph III.3. As we saw above, most families do not receive government child care assistance (only 13% of eligible children are covered). A wide range of situations is shown in Tables III.15 and III.16, in which a distinction is drawn between families who take advantage of child care assistance and those who do not.

We can see that the implicit rates which apply on entry to single-parent families are almost always higher than those of single persons between 30 and 64. The situation is obviously less critical when the child is over six and benefiting from the child care provided at school. However, if the family does not benefit from allowances for child care expenses and the child is under six, the implicit marginal tax rate when entering the labour market is never below 75% unless it is a case of working at the average on industrial wage; this implicit marginal tax rate on entry may even reach 100% for full-time employment at the minimum wage, and 94% for part-time employment at the minimum wage.

The situation is even less attractive for the second spouse who wishes to enter the labour market, if we consider the previously analysed case where two children under six were dependent on this spouse. The latter loses money for any employment at the minimum wage if the household does not benefit from assistance for child care expenses. Even for higher incomes the implicit tax rates upon entering the labour market fluctuate between 61% and 84%. The incentive to work is increased if the children are six or over and if the household receives an allowance for child care expenses.

Thus, the combined effect of the tax and transfer systems and the expenses related to child care greatly discourages all those with dependent children from entering the labour market — single-parent families, as well as two-parent families.

These various marginal rates have a bearing on the attraction of work in the underground economy, with the exception of the marginal rate related to child care for an activity which takes the same amount of time in the underground and official economies. It is possible to illustrate just how attractive this underground economy is in Québec by estimating for each type of household how much a social aid recipient without a job must earn

Table III.15

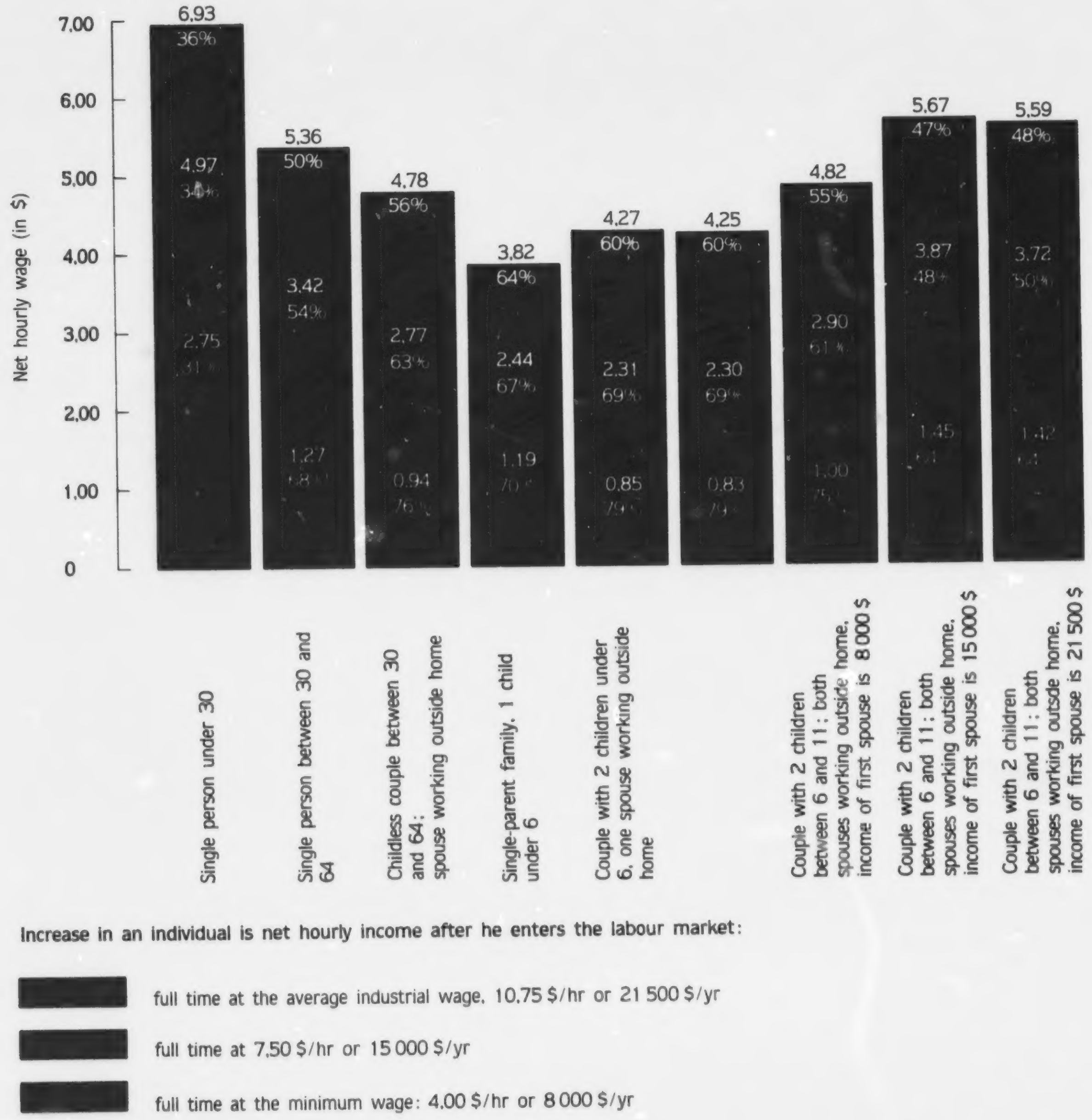
Implicit marginal tax rates[1] for a single person or head of a single-parent family entering the labour market
(in percentage)

		Head of single-parent family with one child under 6		Head of single-parent family with one child between 6 and 11	
Employment income goes from	**Single person between 30 and 64**	**without child care assistance**	**with child care assistance**	**without child care assistance**	**with child care assistance**
0 to 4 000 $	75,6	94,4	64,7	74,6	65,7
0 to 8 000 $	68,1	100,0	70,3	80,2	71,3
0 to 15 000 $	54,3	76,5	67,5	65,5	63,6
0 to 21 500 $	50,1	64,5	64,5	57,1	57,1

[1] The implicit marginal tax rate includes the increase in child care expenses relative to the increase in employment income, where necessary.

Graph III.3

Increase in the net hourly wage after an individual enters the labour market for different types of households
Existing tax and transfer system



Note: The percentage indicated below the net hourly income for each case represents the implicit marginal tax rate including, where applicable, the relative increase in child care expenses with respect to the increase in employment income.

Table III.16

Implicit marginal tax rate[1] for entry of second spouse on the labour market
(in percentage)

Employment income of second spouse entering the labour market	Couple without children				Couple with 2 children under 6				Couple with 2 children between 6 and 11			
	Rate for entry of second spouse When the first already earns				Rate for entry of second spouse When the first already earns				Rate for entry of second spouse When the first already earns			
	8 000 $	15 000 $	21 500 $	50 000 $	8 000 $	15 000 $	21 500 $	50 000 $	8 000 $	15 000 $	21 500 $	50 000 $
Without child care assistance												
0 to 4 000 $	36	25	28	37	124	107	106	115	85	67	66	76
0 to 8 000 $	39	29	30	36	127	106	107	112	84	64	64	70
0 to 15 000 $	38	32	33	36	84	69	71	71	61	48	50	51
0 to 21 500 $	39	34	35	37	71	62	62	61	55	47	48	47
With child care assistance												
0 to 4 000 $	36	25	28	37	68	69	89	115	70	62	66	76
0 to 800 $	39	29	30	36	79	80	102	112	75	64	64	70
0 to 15 000 $	38	32	33	36	70	65	71	71	61	48	50	51
0 to 21 500 $	39	34	35	37	69	62	62	61	55	47	48	47

1. The implicit marginal tax rate includes the increase in child care expenses relative to the increase in employment income, where necesseary.

under the table to reach the same disposable income as he would have if he worked full time on the official market at the minimum wage, for example. This calculation was carried out for three different levels of remuneration on the official market and for seven typical households (Table III.17).

A couple between 30 and 64 with two children under six need only earn $1 699 a year in undeclared income to have the same disposable income as it would with a full-time job at the minimum wage held by one of the spouses. If the two children are between 6 and 11, it would only need to earn $1 669. For either of these two-parent families, if one spouse could work full time in the underground economy at the minimum wage, disposable income would be almost equivalent to working at the average industrial wage on the legitimate market. Under-the-table earnings are just as attractive for single-parent families and single persons 30 or over. The tax and transfer system thereby makes illegality most appealing.

3.3.2.3 Economic indicators

The high implicit marginal tax rates Québec taxpayers have to put up with engender major losses in economic efficiency. The result is a decline in employment, production, consumption and the tax base, and an economic loss that can be measured. To weigh the impact of the tax and transfer system on these economic variables, a more comprehensive indicator than we have used thus far is required. The concept of economic loss enables us to measure the effects of all the distortions in the behaviour of households produced by the tax and transfer systems. It constitutes a composite measurement expressed in dollars of the socioeconomic cost. An **economic model** has been developed to simulate the impact of the reform proposed in Part II of the *White Paper*[22]. It may also be used to measure the losses generated by the present tax and transfer systems, both federal and provincial. However, in practice it is impossible to assess all the economic "leaks" associated with these distortions. The model disregards the losses stemming, for example, from the incentive not to save or those that affect socio-demographic choices. It also ignores the effects of taxation on the mobility of manpower and companies which may either leave Québec or refuse to locate here, as well as the economic loss associated with consumption taxes. Thus, the model underestimates the real economic loss attributable to the current tax and transfer systems.

The procedure for measuring the economic loss consists in comparing the effets of the present federal and Québec tax systems with those of a **lump-sum tax** levying the same net tax bite. A lump-sum tax is levied equally on all citizens. From the point of view of strict economic efficiency, this

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[22] This model, the general equilibirium numerical model of the Québec economy, was developed by Bernard Fortin, and Henri-Paul Rousseau with the assistance of Pierre Fortin, members of the Groupe de recherche en économie politique at Laval University. Its implementation was effected in collaboration with the ACSI computer consulting firm and officials from the ministère des Finances.

Table III.17

Annual remuneration in the underground economy equivalent to disposable income from work on the official labour market by gross income and type of household
(in dollars)

Type of household	**Minimum wage (8 000 $/year)**	**Intermediate wage (15 000 $/year)**	**Industrial wage (21 500 $/year)**
Single person, 18 to 30	5 504	9 944	13 856
Single person, 30 to 64	2 552	6 852	10 720
Single-parent family,[1] head between 30 and 64, one child between 1 and 5	2 375	4 880	7 638
Childless couple, 30 to 64, one spouse working outside the home	1 886	5 543	9 560
Couple, 30 to 64, two children between 1 and 5, one spouse working outside the home	1 699	4 623	8 534
Couple, 30 to 64, two children between 6 and 11, one spouse working outside the home	1 669	4 590	8 503
Couple, 30 to 64, two children[1] between 6 and 11, both spouses working outside the home, one spouse earning 8 000 $	1 993	5 806	9 649

1. For these households, annual remuneration in the underground economy would have to be higher if they incur child care expenses. It has been assumed that workers on the official market receive a child care expense allowance.

type of tax would have no negative economic effect. It creates no difference between the private and social profit from socioeconomic activities, for it is impossible to evade it by changing one's work or savings behaviour. Only migration would enable individuals to avoid it. If this possibility were excluded (as would be the case if the tax were imposed by a world government), such a tax would lead to no economic loss. It is on the basis of this ideal tax concept that the concept of economic loss is defined. In our society, a lump-sum tax is, obviously, not realistic. It is discussed here solely for purposes of illustration.

Take a person who at present must pay $10 000 in federal and Québec income tax and suppose he is freed from the taxation laws by having to make the identical outlay of $10 000, but in the form of a lump sum tax. If his behaviour remains constant, he has the same employment income, the same tax burden and the same number of leisure hours and, consequently, the same level of well-being. However, the lump sum tax, unlike income tax, enables this person to keep his full gross income if he increases his hours of work. Since the relative cost of an hour of leisure rises, one of his reactions is to adjust his number of working hours upward. This is one way of maximizing his economic well-being by making a choice between the value of his working time and that of his leasure time. It is obvious that the level of well-being attained by the individual after the abolition of this income tax is higher. This increase in individual well-being, when translated into dollars, represents the economic loss associated with the tax in question. The concept of economic loss used by the numerical model is the summation of this loss for the population as a whole.

Table III.18 shows the value of economic loss in Québec in 1983, by category of worker and by assumption of labour supply reaction of taxpayers to the tax and transfer system. The total **dead loss** associated with federal and provincial taxes and transfers as applied in Québec seems to be highly significant, some $8.4 billion (1980 dollars) according to the average reaction assumption and $19.4 billion (1980 dollars) according to the strong reaction assumption. Thus the economic loss is probably between 15.3% and 35.3% of Québec's **net domestic product**, estimated at about $55 billion (1980 dollars).

It is found that highly qualified workers bear over 50% of the excess tax and transfer burden even though they make up less than 10% of the total population between 18 and 64. The value of the economic loss is greater among highly qualified workers because of the relatively high productivity level for this category of manpower.

The economic loss calculated in this way is of course not the only criterion for evaluating a tax. Criteria associated with distributive justice are just as important for, despite its merits in terms of economic efficiency, a lump sum per capita tax involves consequences that are probably unacceptable in terms of income distribution. Nevertheless the scope of the estimates does make one wonder about the economic impact of the federal and Québec tax and transfer systems. This is a factor of paramount importance to be considered when it comes to modifying or improving the system. It would be possible to step up production in the whole of Québec's economy and raise the standard of living of all its people by reducing the negative effects of the tax and transfer systems. The same conclusion applies for the Canadian economy as a whole.

3.4 The Question of Equity

The tax and transfer systems should treat the various categories of households in such a way that the ability of each one to meet its essential needs is recognized. A partial analysis of this question was undertaken in the preceding chapter, where certain inconsistencies of the current system were brought out. We can now approach the question from a more general perspective since, in this chapter, we have examined the monetary value of the basic needs of the various types of households and can now derive an assessment of their respective ability to pay.

To evaluate the equity of the tax system for various categories of households, it is possible to compare the taxes levied with the ability to pay, that is, with income in excess of the accepted level of essential needs and the expenses incurred in earning such income. This ratio is the tax rate on ability to pay. For every category of household, the same tax rate should apply for a given ability to pay. In an equitable tax system, the rate curves for taxation on ability to pay applied to different categories of taxpayers should be very close to one another.

When income is insufficient and ability to pay becomes negative, the amount of government assistance should be compared to the accepted level of essential needs, including the expenses of earning income; this forms the assistance rate. For example, when a household earns no income, it makes no contribution to the financing of its essential needs; the assistance rate reaches its maximum at this point. When total transfers equal the accepted level of essential needs, the assistance rate is 100%.

Table III.18

Economic loss associated with taxation and transfers in 1983
(in millions of 1980 dollars)

Type of worker qualification	**Average reaction of labour supply**	**Strong reaction of labour supply**
Poor	1 274	3 290
Average	2 841	6 370
Superior	4 333	9 742
All types	8 448	19 402

Graphs III.4 and III.5 compare the relative situation of households under 65 for each income level, whether they contribute to the financing of public expenditures or whether they receive government assistance. It is assumed that the essential needs of a single person not living alone are half those of a couple, while those of a single person living alone include additional costs for housing. For the purposes of this analysis, the accepted essential needs are equal to essential and non essential needs of households earning less than $13 700. The following employment expenses are included: an amount equal to 3% of employment income up to a maximum of $500, and child care expenses excluding the amounts paid to a third party to assume part of the household's production.

The first thing to emerge from a comparison of the relative situation of households under age 65 is their unequal treatment under the transfer system. It can be seen in Zone A of the graphs that the single person under age 30 appears to be obviously and systematically placed at a disadvantage. In this case, however, the situation could be exaggerated since the essential needs of the person under 30 have not been adjusted to take account of the fact that, given his lack of experience, his short-term employment income prospects are often lower. The transfer system appears to be relatively more favourable to single persons who share living quarters with others, whether over or under 30, than to those who live alone. For couples, the transfer system seems relatively fair, depending on whether or not they have children and whether only one or both spouses are on the labour market. However, they are at a disavadvantage in comparison to single persons 30 or over. In Zone A, problems of equity arise primarily in relation to the treatment of different categories of single persons.

As previously mentioned, the Québec transfer system has a **high assistance** rate since, except for childless couples and single persons under 30, it generally does not fall below 90% of the essential and nonessential needs of full-time workers, belonging to households in the first decile of income. In some cases, the assistance rate can even reach 110% of the short and long-term essential needs and the important but nonessential needs of these full-time workers.

The different rates of compensation applicable to the various categories of households when they have no employment income explain the differences and the erratic progression in the assistance rate curves and the rate curves for taxation on ability to pay (see Zone B), particularly when taken together with the effects already noted (for example, the inadequate coverage of child-related expenses for pre-schoolers and the fact that the program of child care assistance satisfies only a fraction of the need).

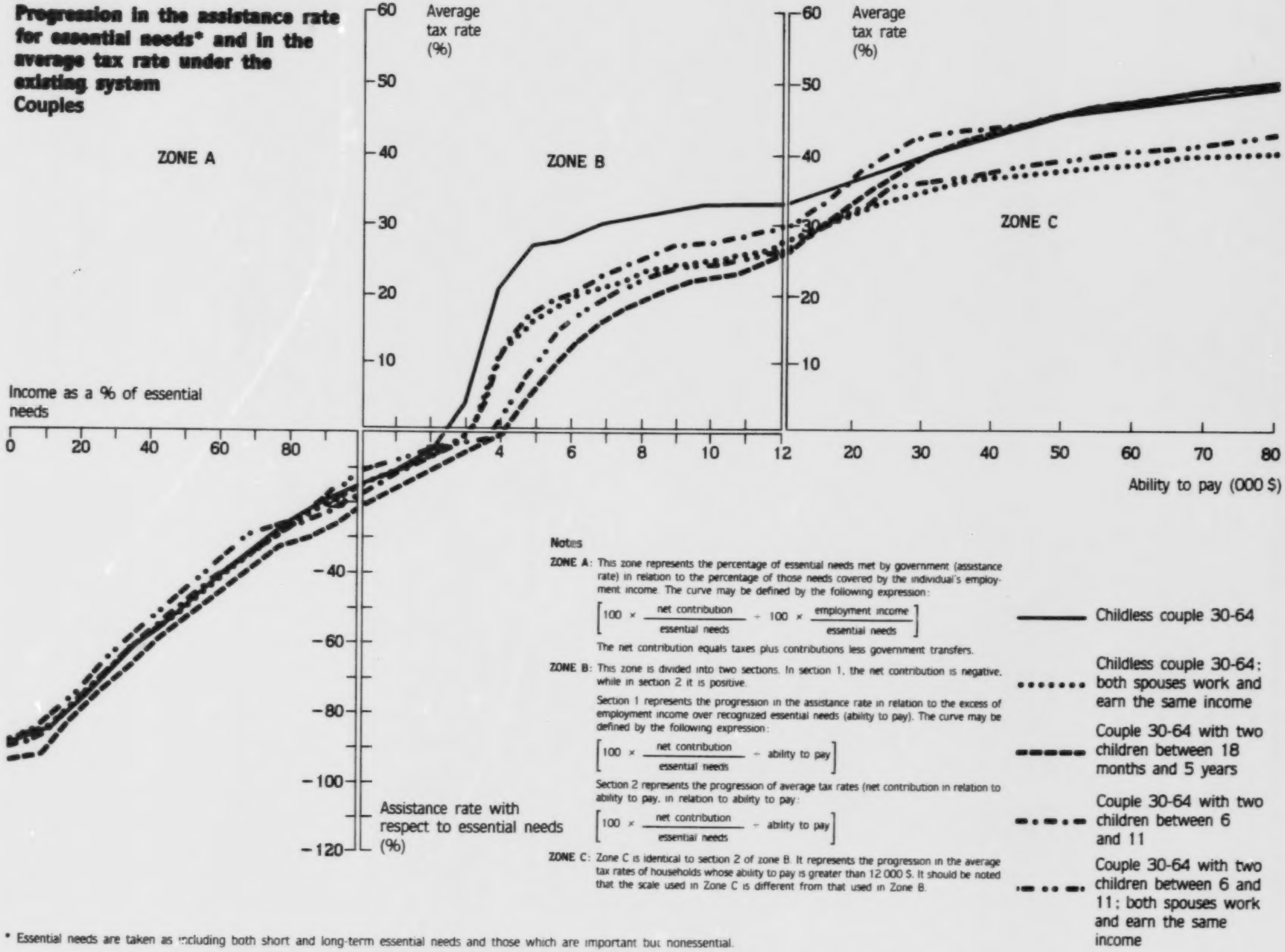
Moreover, in Zone C the couple in which both spouses work in the labour market also receives systematically better treatment relative to the other categories of taxpayers once its ability to pay reaches $20 000, primarily when the couple has no children. This stems from the higher exemptions available when both spouses work as compared to when only one works, and from the choice of a progressive tax table which results in lower marginal tax rates on ability to pay when two spouses are working than when only one spouse works and earns the same income.

When children enter the picture, the couple in which both spouses work in the labour market loses some of its advantage because the existing tax and transfer systems do not always completely allow for child care expenses. It should be noted that the advantage would be cut even further if the two graphs reflected the extra costs, other than the expense of child care, which must be met by couples with children and in which both spouses work, such as the expenses incurred to have others produce a portion of domestic output. Nonetheless, as income increases, the difference in favour of families with children and two spouses working largely makes up for the other child-related expenses, when these couples are compared with single persons. However, when these couples are compared with families with children and only one employment income, the difference is no longer in relation to the implicit value of household work, since it increases with income.

It must be concluded from the foregoing that the goal of equity has been only partially realized. In the transfer system, problems of equity crop up for the different categories of single persons. As for the tax system, two-parent families with children between 6 and 11 are at a disadvantage relative to families with children under 6. Also, it is unfair in its treatment of couples where the two spouses work relative to those with only one working. Complete success is difficult to attain given the constraints imposed by the use, in Québec, of the individual as the tax unit and a progressive tax table. However, improvement is certainly possible, even if only by adjusting personal exemptions or transfers to allow for the essential needs identified at the beginning of this chapter, and by reducing the progressivity of the tax system.

Graph III.4

Progression in the assistance rate for essential needs* and in the average tax rate under the existing system
Couples



Notes

ZONE A: This zone represents the percentage of essential needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} \div 100 \times \frac{\text{employment income}}{\text{essential needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized essential needs (ability to pay). The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} \div \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} \div \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

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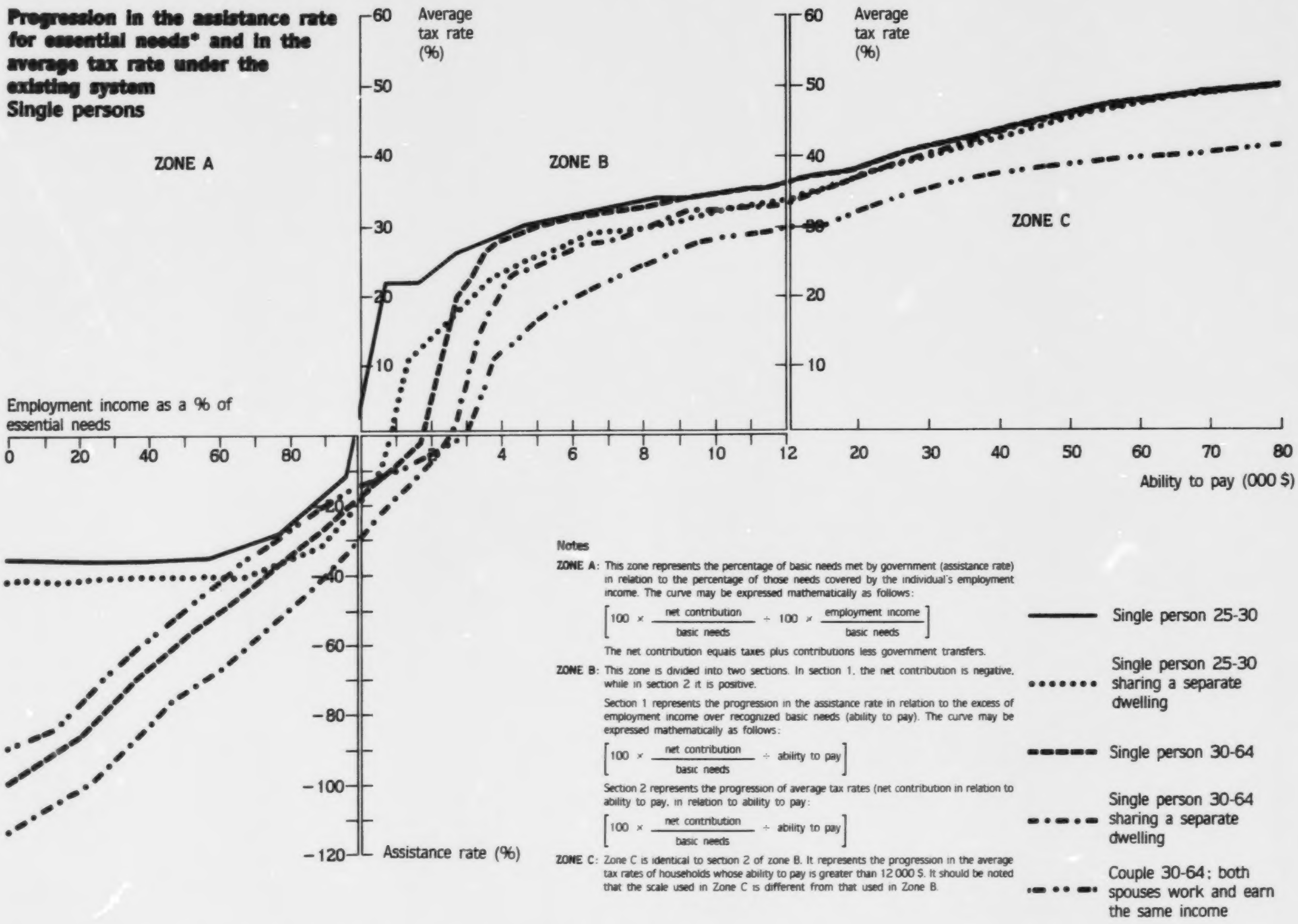
* Essential needs are taken as including both short and long-term essential needs and those which are important but nonessential.

Graph III.5

Progression in the assistance rate for essential needs* and in the average tax rate under the existing system
Single persons



Notes

ZONE A: This zone represents the percentage of basic needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div 100 \times \frac{\text{employment income}}{\text{basic needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized basic needs (ability to pay). The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

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* Essential needs are taken as including both short and long-term essential needs and those which are important but nonessential.

3.5 Redistribution of income

The levels of recognized essential needs for the various types of households were described above. The primary objective of any income redistribution policy is to ensure a level of income necessary to cover their essential needs. The second is to ensure, on the one hand, that government transfers to defray the essential needs of individuals decrease as employment income rises and, on the other, that the average tax rate goes up with the growth in employment income. The taxation aspect of redistribution was examined in Chapter II and the transfer aspect in the first part of this chapter. These two dimensions must now be considered together.

Before going futher, it is important to discuss the concept of distributive justice. This concept poses some very delicate problems. First of all, no objective theory for the equitable distribution of income exists, even though there are as many concepts of distributive justice as there are ideologies. It is also very important to distinguish between poverty and income inequality: a society without poverty might reflect great inequality while another, characterized by great poverty, might have no serious income inequalities. It follows, then, that a policy which seeks to reduce the inequalities will not necessarily reduce the poverty.

One must also be very careful not to confuse income inequality with inequality of well-being. The former concept reflects a wide variation not only in the ability to generate income but also in the use of this ability to earn income. This ability to earn income will depend specifically on attitudes to work, risk-taking, non-monetary fringe benefits or on educational or occupational training choices. For example, can it be maintained that a person who works 60 hours a week and earns $20 000 enjoys a higher standard of well-being than someone who earns $18 000 working only 30 hours a week? Moreover, the choice of time scale and family unit on which the definition of income is based has an effect on the measure of inequality. Does a medical student fall into a low-income category? Should the income of a household include the value of work done at home by a spouse? Should family or individual income be used as basis of measurement of ability to pay?

Since any composite index of inequality implies a value judgment, allowing an inter-personal comparison of well-being, one must be careful in interpreting the results. Moreover, estimating the distribution of income in a society is one thing, appreciating the impact of government intervention on this distribution is another. First, we may calculate how much the State pays in transfers and collects in taxes in each income bracket. This is done in subsection 3.5.1 which attempts to assess the redistributive character of various taxes. In the following subsection, the question of income inequality is broached and in subsection 3.5.3, the attempt is made to show the two in relation to one another by tracing their evolution over the years. It will then be possible to shed a certain light on the role of the State in the evolution of income redistribution.

3.5.1 Redistributive character of various taxes in Québec

Graphs III.4 and III.5 show that the rate of assistance for essential needs recognized by government decreases as income increases, while the rate of taxation applied to ability to pay increases with income. The Québec tax and transfer system effects a significant redistribution of income.

Table III.19 illustrates the same phenomenon in relation to employment income rather than in terms of ability to pay. The results are the same: the government progressively taxes 0% to 55% of a taxpayer's income (for a single person earning $150 000) and furnishes a two-parent family with two children under six and no employment income with transfers of $9 908 net of tax.

Since there are no objective standards as to what is a desirable degree of redistribution, it is interesting to compare Québec with Ontario. A measure can be devised for the variation in the net contribution of government expenditures of a household having an employment income varying from $0 to $75 000 (Table III.20). It shows that the tax and transfer systems in Québec are much more progressive than those in Ontario. With the exception of single persons under 30, the Québec tax and transfer systems invariably provide more than do the Ontario systems for persons with no income and require a higher **net contribution** from those who earn $75 000.

As a result, the spread between the net contributions on incomes of $0 and $75 000 respectively is always wider in Québec. Thus, increases in income are, on the whole, more heavily taxed in Québec because of the higher progressivity of Québec's tax and transfer systems. The manner in which this affects the distribution of income in Québec can now be examined.

3.5.2 Income inequality

The simplest way of mesuring the degree of inequality in the distribution of income consists in dividing up the population into equal strata in ascending order of income and observing what portion of the total income is received by each stratum. It is also possible to measure the redistributive impact of the transfer system by comparing the distribution of income among these strata before and after transfers.

This is done in Table III.21 showing the role of the State with regard to the distribution of income and the part played by taxes, transfers and private income in determining disposable income. Before analysing the results given in Table III.21, it is nevertheless important to define three basic concepts which will make understanding easier: private income, total income and disposable income.

Private income includes all household income from employment, rent and investment, but not the amounts received in government transfers. The household's total income is the sum of its private income and government transfers income. And diposable income is its total income less the taxes payable. The comparison of the distribution of income by strata before and after the effects of the tax and transfer systems will make it possible to pass judgment on their ability to redistribute income.

Table III.21 reveals that the first two **income quintiles**, the poorest of Québec households, have little private income. The result can be explained by the fact that this group is made up largely of the unemployed, those unable to work, pensioners, part-time workers and social welfare recipients. The first quintile has almost no private income (0.4%) while the second has about 8% of all private income. At the other end of the income scale, the fifth quintile earns almost half of all private income, that is 47.5%.

The transfer system mitigates these disparities to a certain extent by increasing the share of the first two quintiles to 3.7% and 9.6% respectively of total household income and reducing that of the fifth quintile from 47.5% to 43.9%. When the effect of taxes is taken into account, the share of the wealthiest drops to 41.3% while that of the first two quintiles rises to 4.3% and 10.7% respectively.

From an analysis of Table III.21, it is clear that transfers play a more important role than income tax in the distribution of income, by substantially increasing the share of income which goes to the first two quintiles. Taxes have a less marked effect, although they increase the share of income received by the first three quintiles. Moreover, overall transfers are so important in relation to private income that they reduce the share of income of the fifth quintile more than income tax does. The net effect of the tax and transfer systems is to transfer part of the income from the wealthiest 60% of households to the poorest 40%. Although the third quintile's share of diposable income is higher than its share of private income, its net contribution to government financing is nonetheless positive.

The overall impact of the tax and transfer systems on income distribution may be summarized as follows: taking account of the effect of taxes and transfers, the income of the first two quintiles goes up from 8.3% to 15% of all household income while it falls from 75% to 67% for the fourth and fifth quintiles. For the third quintile the proportion remains fairly stable at 18% of household income.

Interpretation of these results calls for a serious reservation however: the distribution shown in Table III.21 is a distribution of household income, not of personal income. Since household income is the sum of the incomes of the persons making it up, household income tends to rise with the number of persons.

As a result, there is some reason to believe that Table III.21 overestimates the degree of disparity in income distribution and that, in reality, income dispersal is certainly not as great. Moreover, certain studies which reduce individual income and household income to an equivalent basis confirm this assertion. These studies will form the basis of the analysis of the redistributive effects of the reform which will be carried out in Chapter VI.

Table III.19

Net contribution to government expenditure after taxes and transfers
1983 taxation year
(in dollars)

Type of household	**Employment income**	**Government transfers[1]**	**Taxes[2]**	**Net contribution to government ($)**	**Net contribution as % of employment income**	**Child care costs**	**After-tax income**
1. Single person under 30	0	1 758	143	− 1 615	—	—	1 615
	5 000	675	544	− 131	− 3	—	5 131
	10 000	—	2 068	2 068	21	—	7 932
	12 000	—	2 877	2 877	24	—	9 123
	15 000	—	4 156	4 156	28	—	10 844
	17 000	—	5 017	5 017	30	—	11 983
	20 000	—	6 338	6 338	32	—	13 662
	25 000	—	8 588	8 588	34	—	16 412
	30 000	—	10 987	10 987	37	—	19 013
	40 000	—	16 039	16 039	40	—	23 961
	50 000	—	21 544	21 544	43	—	28 456
	60 000	—	27 163	27 163	45	—	32 837
	75 000	—	36 236	36 236	48	—	38 764
	100 000	—	51 805	51 805	52	—	48 195
	150 000	—	82 928	82 928	55	—	67 072
2. Single person 30 to 64	0	4 815	349	− 4 466	—	—	4 466
	5 000	1 142	593	− 549	− 11	—	5 549
	10 000	—	2 088	2 088	21	—	7 912
	12 000	—	2 901	2 901	24	—	9 099
	15 000	—	4 181	4 181	28	—	10 819
	17 000	—	5 060	5 060	30	—	11 940
	20 000	—	6 401	6 401	32	—	13 599
	25 000	—	8 641	8 641	35	—	16 359
	30 000	—	11 030	11 030	37	—	18 970
	40 000	—	16 067	16 067	40	—	23 933
	50 000	—	21 561	21 561	43	—	28 439
	60 000	—	27 171	27 171	45	—	32 829
	75 000	—	36 233	36 233	48	—	38 767
	100 000	—	51 785	51 785	52	—	48 215
	150 000	—	82 872	82 872	55	—	67 128
3. Single-parent family with one child under 6	0	6 587	− 453	− 7 040	—	—	7 040
	5 000	5 400	− 190	− 5 590	− 112	1 950	8 640
	10 000	3 700	157	− 3 543	− 35	3 120	10 423
	12 000	2 774	787	− 1 987	− 17	3 120	10 867
	15 000	1 430	1 699	269	2	3 120	11 611
	17 000	1 040	2 350	1 310	8	3 120	12 570
	20 000	260	3 580	3 320	17	3 120	13 560
	25 000	—	5 608	5 608	22	3 120	16 272
	30 000	—	7 987	7 987	27	3 120	18 893
	40 000	—	13 052	13 052	33	3 120	23 828
	50 000	—	18 341	18 341	37	3 120	28 539
	60 000	—	23 929	23 929	40	3 120	32 951
	75 000	—	32 726	32 726	44	3 120	39 154
	100 000	—	48 326	48 326	48	3 120	48 554
	150 000	—	79 505	79 505	53	3 120	67 375

Table III.19 (continued)
Net contribution to government expenditure after taxes and transfers
1983 taxation year
(in dollars)

Type of household	**Employment income**	**Government transfers**[1]	**Taxes**[2]	**Net contribution to government ($)**	**Net contribution as % of employment income**	**Child care costs**	**After-tax income**
4. Couple with two children under 6; one spouse works outside the home	0	8 807	−1 101	−9 908	—	—	9 908
	5 000	5 022	−849	−5 871	−117	—	10 871
	10 000	1 784	−491	−2 275	−23	—	12 275
	12 000	1 118	−88	−1 206	−10	—	13 206
	15 000	119	771	890	6	—	14 110
	17 000	—	1 849	1 849	11	—	15 151
	20 000	—	3 155	3 155	16	—	16 845
	25 000	—	5 349	5 349	21	—	19 651
	30 000	—	7 897	7 897	26	—	22 103
	40 000	—	13 387	13 387	33	—	26 613
	50 000	—	18 885	18 885	38	—	31 115
	60 000	—	24 517	24 517	41	—	35 483
	75 000	—	33 662	33 662	45	—	41 338
	100 000	—	49 495	49 495	49	—	50 505
	150 000	—	81 145	81 145	54	—	68 855
5. Couple with two children between 6 and 11; one spouse works outside the home	0	8 842	−640	−9 482	—	—	9 482
	5 000	5 022	−392	−5 414	−108	—	10 414
	10 000	1 784	−28	−1 812	−18	—	11 812
	12 000	1 118	381	−737	−6	—	12 737
	15 000	119	1 242	1 361	9	—	13 639
	17 000	—	2 309	2 309	14	—	14 691
	20 000	—	3 631	3 631	19	—	16 369
	25 000	—	5 829	5 829	23	—	19 171
	30 000	—	8 375	8 375	28	—	21 625
	40 000	—	13 872	13 872	35	—	26 128
	50 000	—	19 344	19 344	39	—	30 656
	60 000	—	25 015	25 015	42	—	34 985
	75 000	—	34 124	34 124	45	—	40 876
	100 000	—	49 957	49 957	50	—	50 043
	150 000	—	81 610	81 610	54	—	68 390
6. Couple with two children between 6 and 11; both spouses work and earn the same income	0	8 842	−731	−9 573	—	—	9 573
	5 000	5 461	−658	−6 119	−122	975	10 144
	10 000	2 662	−281	−2 943	−29	1 950	10 993
	12 000	2 054	−64	−2 118	−18	2 340	11 778
	15 000	997	474	−523	−3	2 925	12 598
	17 000	702	1 015	313	2	3 120	13 567
	20 000	234	1 863	1 629	9	3 120	15 251
	25 000	—	3 733	3 733	15	3 120	18 147
	30 000	—	5 917	5 917	20	3 120	20 963
	40 000	—	10 656	10 656	27	3 120	26 224
	50 000	—	15 109	15 109	30	3 120	31 771
	60 000	—	19 815	19 815	33	3 120	37 065
	75 000	—	27 413	27 413	37	3 120	44 467
	100 000	—	41 331	41 331	41	3 120	55 549
	150 000	—	71 501	71 501	48	3 120	75 379

1. The transfers related to income which were considered are social aid, work income supplement, and child care expense deductions.

2. Taxes include income tax, property taxes, consumption taxes and contributions to the QPP and unemployment insurance. From the total amount of such taxes were deducted transfers comparable to taxes (availability allowance, Québec and federal family allowances and the federal child tax credit). The property tax refund was deducted from property taxes.

Table III.20

Net contribution to public financing in Québec and Ontario for incomes of 0 $ and 75 000 $
1983 taxation year
(in dollars)

			Difference	
	Québec	**Ontario**	**($)**	**(%)**
Single person under 30				
— no income	− 1 615	− 3 186		
— 75 000 $ income	36 236	31 085		
— Difference between the two	37 851	34 271	3 580	10,4
Single person 30-64				
— no income	− 4 466	− 3 372		
— 75 000 $ income	36 233	31 049		
— Difference between the two	40 699	34 420	6 279	18,2
Single-parent family with one child under 6				
— no income	− 7 040	− 6 499		
— 75 000 $ income	32 726	28 582		
— Difference between the two	39 766	35 081	4 685	13,4
Couple with two children under 6 and only one employment income				
— no income	− 9 908	− 7 710		
— 75 000 $ income	33 662	30 019		
— Difference between the two	43 570	37 729	5 841	15,5
Couple with two children between 6 and 11 and only one employment income				
— no income	− 9 482	− 7 818		
— 75 000 $ income	34 124	30 019		
— Difference between the two	43 606	37 837	5 769	15,2

Source: *Ministère des Finances.*

Table III.21

Distribution of income among households by income quintile in Québec, 1979
(in percentage)

Income quintile (from lowest to highest)	**(1) Private income**	**(2) Total income**	**(3) Disposable income**
		(1) + transfers	**(2) − taxes**
First quintile	0,4	3,7	4,3
Second quintile	7,9	9,6	10,7
Third quintile	17,4	17,2	18,0
Fourth quintile	26,9	25,6	25,6
Fifth quintile	47,5	43,9	41,3

Source: Bureau de la statistique du Québec, based on Statistics Canada's study of consumer finances.

Table III.22

Distribution of total income among households in Canada, 1961 and 1971
(in percentage)

Income decile (from lowest to highest)	**1961**	**1971**
First decile	1,1	1,0
Second decile	3,1	2,7
Third decile	5,1	4,4
Fourth decile	6,9	6,3
Fifth decile	8,4	8,0
Sixth decile	9,9	9,7
Seventh decile	11,4	11,4
Eighth decile	13,2	13,4
Ninth decile	15,9	16,3
Tenth decile	25,0	26,8
Gini ratio	0,368	0,398

Source: R. Love, *Income Distribution and Inequality in Canada*, Statistics Canada, Cat. 99-755E, March 1979.

3.5.3 Changes in recent years

To better understand the government's role in the redistribution of income, it is useful to examine how the situation has evolved in recent years. Studies devoted to the question generally conclude that the distribution of income did not become more egalitarian during the 1950s, 1960s and 1970s, despite efforts made to fight poverty and inequality. On the contrary, it became slightly less egalitarian.

It is Canadian studies which make it possible to go back the furthest and view the changes in income redistribution on a comparable basis. Table III.22 illustrates and compares distribution of income in Canada between 1961 and 1971. It shows that the first half of the population saw its share of **total income** drop from 24.6% to 22.4%. This situation seems astonishing, considering the manner in which transfer programs grew during this period.

Income distribution may also be compared in a more sophisticated manner. The composite index most frequently used to represent the degree of disparity in income distribution is the **Gini ratio**, whose value fluctuates between 0 and 1. The ratio is calculated on the basis of income centiles; in other words, households are divided into 100 groups of equal numbers, in ascending order of income. A ratio equal to 0 means that income is distributed equally among households from one centile to another, while a value of 1 means that total income is held by the households of a single centile. Table III.22 presents this index and indicates that there has been a deterioration in income distribution, for the factor went up by 0.03 between 1961 and 1971.

A study carried out by the Office de planification et de développement du Québec[23] sheds further light on the question. It deals with the period from 1967 to 1975; but certain data are also available for 1979. Tables III.23 and III.24 present the results.

Table III.23 shows what effect transfers have had on the share of income of households in the first **income decile** and the first income quintile. In the case of the first quintile, the share of **private income** dropped, but this drop is more than offset by the growth in transfers. All told, the first quintile's share of total income increased slightly following transfers. In the case of the first decile, no significant change is observed.

The evolution of the Gini ratio (Table III.24) associated with the distribution of private income as well as the share of income held by family units below the median shows that the distribution is

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[23] Office de planification et de développement du Québec (1980), *L'impact des transferts sur la répartition des revenus au Québec* — 1967-1975, Québec, 95 pp.

Table III.23

Changes in the share of income of the first decile and quintile due to transfers, Québec, 1967-1979

	1967 %	1971 %	1973 %	1975 %	1979 %
First decile					
Share of private income	−0,1[1]	n.s.[2]	−0,2	−0,1	n.a.
Share of total income	0,8	0,7	0,9	0,9	n.a.
Change due to transfers	0,9	0,7	1,1	1,0	n.a.
First quintile					
Share of private income	0,8	0,3	0,5	0,3	0,4
Share of total income	3,4	3,0	3,5	3,3	3,7
Change due to transfers	2,6	2,7	3,0	3,0	3,3

1. The first decile's share of private income is negative because it includes self-employed people who have lost income, and family units without private income.

2. n.s.: Not significant, that is, less than 0,1%.

Source: OPDQ, special compilation based on micro-data concerning family income from the study devoted to consumer finances, for the years 1971, 1973, 1975 and 1979, and unpublished data for 1967 from Statistics Canada.

Table III.24

Degree of inequality in distribution of private and total income Québec, 1967, 1971, 1973 and 1975

	Years of strong economic cycle		Years of weak economic cycle	
	1967	1973	1971	1975
Gini ratio				
• Private income	0,446	0,469	0,482	0,483
• Total income	0,397	0,408	0,424	0,414
• Differential due to transfers	0,049	0,061	0,058	0,069
Share of income held by family units under the median				
• Private income	19,0	16,7	16,0	15,4
• Total income	22,5	21,3	20,3	20,7
• Differential due to transfers	3,5	4,6	4,3	5,3

Source: Office de planification et de développement du Québec (1979). *Évolution de la répartition des revenus au Québec 1961 — 1976: quelques facteurs explicatifs.* (Québec: Direction des études et systèmes socio-économiques), p. 93.

less egalitarian in periods of recession than in expansionary times. This result confirms that the slowdown in the economy hits low-income families harder than those with higher incomes and that the best way of improving one's economic position is to earn employment income.

Comparison of the distribution of private income with that of total income shows that transfers have achieved, at least in part, their objective of redistributing income since the Gini ratio associated with the distribution of total income is lower than that associated with the distribution of private income and that this differential, although very slight, has increased with time, and that it is higher in weak economic cycles. However, although transfers have increased, the distribution of income deteriorated from one strong economic cycle to another (1967 to 1973) as well as from one weak economic cycle to another (1971 to 1975).

On the basis of these observations, it may well be asked how effective are the tax and transfer systems in redistributing income. Indeed, it appears that transfers to disadvantaged categories of the population are more or less cancelled out by the drop in their income from other sources. Using the **numerical general equilibrium model of the Québec economy**, we will show in Chapter VII that this is no accident: ultimately, transfers have a demotivating effect on the ability or willingness of individuals to earn income of their own.

3.6 Specific Problems Caused by the Tax and Transfer Systems

This last section concerns problems that are more specific to each of the topics examined and groups these problems under three headings, namely lack of integration with other components of the tax and transfer systems, lack of coordination with other government policies and, lastly, impact on the social and economic behaviour of individual citizens.

3.6.1 Integration problems

The tax system and the transfer system were designed independently of each other and mutual compatibility was not a matter of great concern. The same is true of the various transfer programs themselves. As a result, the two systems apply different criteria when determining how much tax a taxpayer will pay or how much he will receive in transfers. This situation affects equity among taxpayers and the efficiency of the economy, not to mention the administrative complexity of the system as a whole.

An analysis of the lack of integration may be carried out on the basis of four criteria: similar or dissimiliar definitions of a household, income and assets taken into account, periods of reference. A further aspect can be considered: the administrative integration of needs to be covered.

3.6.1.1 Definition of household

The principles underlying the tax system and the transfer programs with respect to defining the declaration unit (taxpaying unit or **transfer unit**) are completely different. While the tax system is based on the individual, the declaration unit of the transfer programs is made up of households which vary in size.

Under the tax system, it is the individual's ability to pay which is considered when assessing how much income tax he must pay. His tax liability is based solely on his income and does not vary with the income of other members of his family or household, unless an exemption is claimed for these people as dependents. Because of the formula respecting exemptions for dependents, the tax system is not entirely based on individuals. When their income falls below a certain minimum, certain people may be considered dependents of the taxpayer if they are close relatives: spouses, children, grandchildren, nieces, nephews, brothers and sisters, uncles and aunts, and those of the spouse. Separated or divorced spouses who receive support are also considered dependents. The concept which prevails under the tax system might be described as an individual unit encompassing certain dependents.

For transfer programs, the concept most frequently used is the concept of the family, that is, a group of people who are related to each other and who generally live in the same dwelling. Under social aid, the notion of family includes spouses and their dependent children under 18 and over 18 if they are students. In addition, the notion of spouse embraces de facto spouses.

Within the transfer programs there are problems of integration with two alternative basic income security systems, namely social aid and the student assistance program, as regards the definition of the household and more particularly the consideration of de facto unions and the definition of dependent children.

Social aid recognizes de facto unions in determining essential needs and in calculating the household's income and resources, whereas the student assistance program does not recognize this type of household. Because of this difference, a person may possibly be excluded from both programs and not be entitled to a basic minimum income. Indeed, if a person is living in a de facto union with a beneficiary of the student assistance program, he/she will not be considered in calculating the grant assistance which will be based on the needs of single person; nor will that person be entitled to social aid because he/she is a member of a family of which an adult member is a full-time student at a college or university. Conversely, the two programs lack equity with regard to de facto unions where one of the two partners is working. As far as social aid is concerned, this household could become ineligible because of the salary of one of them. On the other hand, this same household would be eligible for the student assistance program since no account would be taken of the income earned by the partner who works.

A child who has completed his studies is no longer considered dependent on his parents for the purposes of social aid after reaching the age of 18; he is then entitled to social aid as a single person, even though he is still living with his parents and even though the latter can claim tax exemption for this dependent child until he reaches age 21. For its part, the student assistance program regards all unmarried children as being dependent on their parents until they reach the graduate studies level and, in determining the amount of the assistance, even imputes a contribution from the parents to the student's maintenance. There is good reason to consider whether this notion of a parental contribution in the student assistance program should also be extended to the social aid program to avoid penalizing young persons 18 to 20 who are pursuing their studies. On the other hand, the possibility of allowing parents to claim a tax exemption for a dependent child 18 to 20, whether he is attending an educational institution or not, should also be envisaged.

This lack of uniformity creates more than superficial differences. It implies different definitions of ability to pay, as well as certain inequities among taxpayers or categories of taxpayers. Moreover, the lack of uniformity leads to double coverage of essential needs in some cases, while in others those same needs are inadequately met.

For example, it is possible for parents to claim an exemption for an 18-year-old child receiving social aid. Social aid covers the child's basic needs, while the tax system assumes they are met by his parents. But, under the income tax system, a taxpayer may not claim a deduction for a dependent with respect to his de facto spouse; as the latter may not be entitled to social aid, essential needs may be only partially met.

It is not certain that the various components of the tax and transfer systems can be established on the same basis with respect to the definition of the declaration unit. The situation will be analysed further on. Nonetheless, it is certainly possible to eliminate the most obvious inconsistencies.

3.6.1.2 Income and assets considered

There are two major differences in the definitions of income used in the personal tax and transfer systems. The first relates to the nature of income considered. As was stated earlier, income from transfers is often excluded from taxable income. Transfer programs generally take a greater number of sources of income into account. Under the loans and scholarships programs, for example, all income is considered. In this respect, nonetheless, there remain some notable differences, as shown in Table III.25. The definition of income which is employed varies between gross income and income net of taxes and does not always include the same income from transfers.

Table III.25

Definition of income considered in transfer programs and entitlement limits
1983
(in dollars)

Program	**Employment income considered**	**Frequency**	**Transfer income considered**	**Program entitlement limits**[1]
Social aid	Net after taxes and deduction for job-related expenses and after exemption	Monthly (previous month)	All[2], except property tax refund, employment income supplement, LOGIRENTE, the availability allowance, foster family income and financial assistance for child care	1 adult 5 660 1 adult-1 child 7 788 2 adults 8 788 2 adults-2 children 10 165
Work income supplement (WINSUP)	Gross	Annual (previous year)	All[2], except property tax refund, employment income supplement, LOGIRENTE, the availability allowance, foster family income and financial assistance for child care	1 adult 8 429 1 adult-1 child 14 474 2 adults 13 392 2 adults-2 children 15 357
Housing supplement and low rental housing	Gross	Annual (previous year)	All, except property tax refund, employment income supplement, the availability allowance, family allowances and child tax credit, foster family income and financial assistance for child care	
Property tax refund	Net after general deduction of 10% of gross income and personal exemptions	Annual (previous year)	All, except LOGIRENTE, employment income supplement, the availability allowance, family allowances and child tax credit, foster family income and financial assistance for child care	
Financial aid to families using child care services	Net after deduction of recognized employment-related expenses	Annual (previous year)	All	1 adult-1 child 21 361 2 adults-2 children 32 161
Legal aid	Gross	Weekly	Same as social aid	1 adult 8 840 2 adults-2 children 11 960
Student assistance (parental contribution)	Net after taxes and after various deductions for family responsibilities and business expenses	Annual (previous year)	All, except first 500 $ in scholarships and grants	2 adults 1 child, resident college student 28 550 1 child, non-resident university student 38 550

1. This is gross earned income at which the benefits paid by these programs cease.

2. Federal and Québec family allowances and the federal child tax credit, even though excluded in the definition of income, are taken into consideration in computing the benefit.

Although the social aid program does not, with the exception of dividends, consider income from property, other programs do include them in their definition of income. The principal transfer program, social aid, is only concerned with the assets themselves, not with income derived from them. Under the personal tax system, the opposite is true. In proceeding as it has, the social aid program has opted for administrative simplicity. We know that the tax legislation governing such income is complex.

The second concerns the method and the period used to calculate income. The underlying principle of the personal tax system is to tax the surplus generated by assets when it is received. The transfer system cannot afford to ignore these assets, or the gains related to non-realized surplus. While taxes may be levied after the gain has actually been realized, the transfer system cannot proceed in this manner. Any high-income taxpayer whose income fluctuates from year to year could benefit from transfers during his low-income periods.

In addition, none of the transfer programs take into account income generated by property, including interest, dividends, capital gains. Table III.26 shows these various methods.

3.6.1.3 Period of reference

Moreover, determining the level of social aid benefits to which a person is entitled on a monthly basis, while calculating taxes on an annual basis without taking the amount of social aid benefits received into account, leads to unfair treatment and reduces the effectiveness of the transfer programs. For example, Table III.27 shows that a household which receives social aid benefits during six months of the year and earns $10 000 during the other six months ends up with $2 659 more disposable income (net of taxes and transfers) than a household which works during the entire year to earn the same income. This situation can be explained essentially by the fact that social aid benefits are not taxable even when they enable the recipient to

Table III.26

Assets considered in the transfer programs — 1983

Program	Exemptions permitted	Percentage imputed as income from assets over and above permitted exemptions
Social aid	— 40 000 $ principal residence	1% monthly
	— 4 000 $ automobile	1% monthly
	— 2 500 $ other property[1]	1% monthly
	— 2 500 $ liquid assets[1]	100% monthly
	— 2 500 $ cash surrender value of a life insurance policy	100% monthly
Work income supplement	— principal residence	wholly exempt
	— automobile	wholly exempt
	— 50 000 $ liquid assets and other property	ineligibility for the program
Housing supplement and low rental housing	No consideration of assets (currently under review)	
Property tax refund	No consideration of assets	
Financial aid to families using child care services	No consideration of assets	
Legal aid	May vary from one case to another	
Student assistance (parental contribution)	— 50 000 $ for principal residence, liquid assets, other property, automobile, etc.	2% annually

[1] For a single person, these amounts are 1 500 $.

Table III.27

Comparison between the disposable income of a couple working only part of the year and that of a couple working a full year
Childless couple between 30 and 64, with only one spouse working
1983 (in dollars)

	Couple working part of the year	**Couple working a full year on the labour market**
Income earned		
1st period (6 months)	—	5 000
2nd period (6 months)	10 000	5 000
Total	10 000	10 000
Transfers		
Social aid	3 825	—
Other transfers	—	1 130
Total	3 825	1 130
Taxes and contributions	– 205	– 169
Taxes plus transfers	3 620	961
Disposable income	13 620	10 961

earn income above and beyond his essential needs whereas any employment income exceeding this level is taxable. The effectiveness of a program also declines when the beneficiary's income for the previous year is considered in determining the level of benefits for the current year (e.g. the employment income supplement) or when for the student, income for the current year is taken into account while for the parents, the income considered is that of the previous year (student assistance program).

The periods of reference should be harmonized for the different programs or for the different various parts of a program.

3.6.1.4 Definition of needs

The lack of integration among the components of the tax and transfer systems may also lead to the **over-coverage** of certain needs, when two of them cover the same need for the same persons either wholly or partially, as is the case at the moment for housing, or when a program covers a need which is not really necessary, as is sometimes the case for child care.

The over-coverage of the housing need applies to social aid recipients who live in low-rental housing and to all other social aid recipients who receive the property tax refund. Indeed, the social aid program, together with compensation for family responsibilities where necessary, guarantees all households a basic minimum income which covers essential needs, of which housing is one of the most important. According to the scales fixed by the ministère de la Main-d'oeuvre et de la Sécurité du revenu, the proportion of the basic minimum income that can be spent on housing without affecting the coverage of other essential needs varies betwen 34% for two-parent families with two children or more and 47% for single persons, according to the June 1983 figures. However, the low-rental housing program fixes the cost of its housing at a maximum of 25% of the income of the tenant household. At present, over 11 000 of the 41 000 households living in low-rental housing are social aid recipients. These households benefit from good-quality housing for which they pay a far lower rent than that estimated for this need in the basic minimum income guaranteed by the transfer programs (see Table III.28).

This situation is due to the actual method of contribution to housing costs which is applied by the low-rental housing program. In principle, it

Table III.28

Housing cost in basic minimum income and real housing cost in low-rental housing for various households receiving social aid

Type of household	Basic minimum income[1]	(a) Cost of housing estimated in the basic minimum income		(b) Real cost for the recipient of housing low rental housing		Difference (a) − (b)
	$	$	%	$	%	$
Single person	403	188	47	98	24	90
1 adult and 1 child	601	250	42	112	19	138
2 adults and 2 children	853	290	34	128	15	162

1. Includes social aid, federal and Québec family allowances and the federal child tax credit, according to June 1983 levels.

would seem more reasonable, when a special program covers an essential need that is already included in the basic minimum income, for the contribution payable by the beneficiary to be at least equal to that provided for in the basic minimum income for that need.

Similarly, property taxes paid by tenants (they are included in the rent) and by owners on social aid are covered in both the basic minimum income and in the property tax refund. Since this refund is not regarded as income by social aid, this need is doubly covered. It would seem more logical to reduce a household's property tax refund to take account of amounts already paid to avoid this double coverage.

Another problem of this over-coverage stems from the lack of integration between the social aid program and the student assistance program. When the parents of a student are considered by the scholarship program to be incapable of providing for his needs, and the student resides with his parents, he receives not only the maximum amount of assistance but also a special allowance to pay his parents for his board. However, if his parents are receiving social aid, the program will regard him as part of this household even if he is over 18, and his parents will receive the assistance corresponding to the needs of a child, as defined in the social aid program. In this way the cost of a student's board when he lives with his parents will be covered by both programs at the same time.

The problem of over-coverage occurs in a different way with respect to child care costs. In this case, a specific program, financial assistance for parents using child care services, is intended to cover a need which is not really essential in the case of social aid recipients. Although this assistance may prove necessary and very useful for households working for a low wage and for persons returning to studies or enrolled in a training program, there is reason to question this assistance when it is granted to families receiving social aid who participate neither in the labour market nor in training programs.

It is easy to understand, of course, especially in the case of single-parent families, that such a household may have occasional need for child care services, but when it is realized that a large part of financial assistance for child care services is paid to families on social aid, the appropriateness of these outlays may be questioned, especially with regard to all two-parent families receiving social aid or for single-parent families who use these child care services on a regular basis.

The problems of integration and coherence that we have just discussed have several negative consequences. The first concerns the goal of equity which is not properly achieved because ability to pay or essential needs are poorly evaluated. If it is fair to consider assets in assessing the ability to pay, the redistribution programs which disregard them are unfair to the beneficiaries of the other programs. A second problem arises from the disincentives caused by the lack of integration. For example, the double coverage of certain needs certainly encourages those who benefit from them to remain dependent on the State. This also means that the lack of integration is a drain on the social security budget. Lastly, it is a far cry from the system's goal of simplicity.

3.6.1.5 Administrative integration

Administratively speaking, the tax and transfer systems are scarcely integrated. First, because of the confidential nature of tax returns, they are not available to those who administer the transfer programs. The same applies to statements of income supplied, for example, by employers and financial institutions, which are sent to the ministère du Revenu, but not to officials of the transfer program.

On the other hand, records of income compiled by the administration of the transfer programs are generally forwarded to the ministère du Revenu. Although most transfers paid by the government are not directly taxable, the ministère du Revenu needs information about the amount of transfers paid to a taxpayer to calculate the property tax refund and the work income supplement to which he is entitled. The ministère du Revenu has files which enable it to detect the most blatant cases of fraud, that is, cases in which a taxpayer declares income under one system but not the other. Since the ministère du Revenu does not pass on information to the officials who administer government transfers, the latter must rely upon their own resources.

On the other hand, the administrative organization of compensation for family responsibilities is rather cumbersome, for as many as five different departments or agencies may be involved. A two-parent family with one child on social aid will receive an additional $1 562 for this child — from the ministère de la Main-d'oeuvre et de la Sécurité du revenu (increase in social aid cheque of $52 per month), the Régie des rentes du Québec (Québec family allowance of $7.52 per month), Revenu-Québec (availability allowance of $300 per annum), Revenue Canada (child tax credit of $343 for the year) and Health and Welfare Canada (federal family allowance of $17.12 per month).

Not only does this lack of integration lead to inefficiency in the detection of fraud, but it is also extremely costly to the government and the people and renders the system a source of confusion and misunderstanding. Better administrative integration of the tax and transfer systems entails using compatible definitions of income, assets, family unit and so forth, which is not always the case at present. It also implies that the reconciliation periods for sums received and paid out should be the same. Ultimately, administrative integration goes hand in hand with the integration of programs, which should be better reconciled not only with respect to the objectives pursued, but also in terms of administrative methods and principles.

3.6.1.6 Housing assistance

One of the functions of the transfer system is to guarantee all households a minimum income which will enable them to cover their essential needs. The transfer system must therefore, among other things, ensure that all households have sufficient income to allow them access to decent housing.

The objectives of the housing assistance policy are first to ensure that there is a sufficient number of adequate dwellings to meet the demand and also to provide transfer income to certain households when the latter cannot afford decent accomodation. On the one hand, there exists a series of programs to finance the construction and operation of housing; on the other, there is a program to subsidize persons whose housing costs represent over 30% of their income, but for which only persons over the age of 65 are eligible (until October 1984), namely the LOGIRENTE program.

In recent years, housing assistance in Québec has concentrated largely on construction, especially of low-rental housing. The construction of such housing may, of course, prove a very useful alternative to institutionalizing less autonomous senior citizens by giving them access to rental housing offering specific services which they would not obtain in the private sector, while enabling the government to economize in relation to the cost of accomodation in homes for the elderly. However, for other low-income households, the effect of this policy has been to provide a very small number of beneficiaries (less than 3% of households on social aid) with high-quality housing at a very advantageous price, but at a cost to the State that is much higher than the cost of housing offered by the private sector (see Table III.29).

Note that the Société d'habitation du Québec recently raised rents for new tenants of low-rental housing. This has reduced the differential between the average rent paid in the private sector by social aid recipients and the rent paid by recipients who are new tenants in low-rental housing. This increase is nevertheless not sufficient to reach the cost of housing recognized under the social aid scales (Table III.28) or to cancel the necessity for government subsidies to low-rental housing.

The construction of low-rental housing for taxpayers with modest incomes but physically independent constitutes a questionable allocation of available resources, considering the costs involved and the limited clientele it serves. Moreover, the program places such persons in a privileged position compared with others who have similar incomes. In

Table III.29

Comparison of average rents in low-rental housing and private sector for social aid recipients
June 1983
(in dollars per month)

Type of household on social aid	**Average rent in low-rental housing**		**Average rent in private sector ($)**	**Ratio low-rental housing/ private sector (%)**	**Monthly government subsidy**
	New tenants ($)	**All recipients ($)**			
Single person 30 to 64	116	98	172	57	—
Single-parent — 1 child	154	112	211	53	—
Single-parent — 2 or more children	168	113	223	51	—
Childress couple 30 to 64	176	116	197	59	—
Two-parent — 1 child	192	124	212	58	—
Two-parent — 2 or more children	205	128	222	58	—
Average	—	—	—	—	270

Source: Ministère de la Main-d'oeuvre et de la Sécurité du revenu, Fichier de l'aide sociale, June 1983, and Société d'habitation du Québec.

future, greater emphasis should be placed on attempting to ensure fair treatment for all households faced with comparable needs. To this end, one should favour a policy of subsidizing those whose housing costs are too high in relation to their income.

As previously mentioned, such a program already exists, namely the LOGIRENTE program which, until October 1984, is only available to people aged 65 or over, both owners and tenants. Since it is not integrated with the tax system, it may add 22.5% to the implicit marginal rates of eligible persons and would be difficult to extend to persons under 65 and able to work on the same terms. It also has two serious drawbacks; first it does not recognize that owners have accumulated wealth in the equity of their property which gives them greater ability to pay than tenants. Finally, since it compensates for the cost of housing that exceeds 30% of total income, this clientele receives treatment that differs from that accorded social aid recipients, for whom as we have seen it is considered normal to attribute a higher proportion of benefits to housing needs.

3.6.1.7 Educational assistance

The pursuit or resumption of studies, as well as participation in an occupational training program, often constitute an essential stage prior to entering the labour market. The government must therefore ensure coordination of all the policies involved so as to maintain an incentive for education and training. Unfortunately, there are several measures in the transfer system which discourage beneficiaries from improving their general education or occupational training.

Tables III.30 and III.31 compare the benefits paid by the student assistance program with those of social aid for a number of typical cases. The general conclusion is that social aid pays higher benefits to young persons of post-secondary age than the student assistance program.

This program is less financially attractive than social aid for several reasons. The first and most important is that parental income is taken into account under the student assistance program and reduces the amount granted to all students considered to be dependents. The criteria used to determine whether a student is "independent" are rather restrictive: he must be married, have children, be in a graduate university program, or have a certain experience (2 continuous periods of 12 months) on the labour market. On the other hand, any person over 18 may go on social aid and receive a monthly benefit, irrespective of his parents' income.

Another factor stems from the additional needs arising from studies. Social aid recipients have no tuition fees to pay, no transport costs to go to CEGEP or university; they do not have to have meals away from home; they may well be able to pay less for housing. We have attempted to estimate these additional expenses in column six of Table III.31. They represent from $1 200 to $3 500 a year. When these expenses are subtracted from the assistance granted, the amount of social aid can be compared with student assistance for essential needs. Even then the amounts are not always comparable since part of the aid to students is in the form of loans; while social aid is a transfer which does not need to be repaid.

Social aid also offers certain benefits which are not available under the student assistance program. Social aid recipients are entitled to coverage of special needs for themselves and their families — there is no equivalent in the student assistance program. With regard to cash flow, social aid may become available the first month the needs arise (which is not the case with the loans and scholarships); there is a guaranteed monthly income in one case and not in the other.

There are obviously some compatibility problems between social aid and the loans and scholarships program. Considering the additional costs involved in studying at the post-secondary level, it is the students themselves (or their parents) who provide for almost all their essential needs, while the State assumes most of this role for social aid recipients of the same age. This makes sense only if the student is assured of finding a well-paying job at the end of his education. Such a policy in favour of general transfers to young people of student age has the disadvantage of fostering a behaviour of dependency rather than of taking one's own life in hand.

Table III.30

Comparison of amounts granted for essential needs
Student and non-student
Couple with one child
1983-1984
(in dollars)

	Situation of child				
			Student	**Non-student**	
Parental employment income	**Student living with parents**	**Level of studies**	**Essential needs**	**18 or over**	**Under 18**
None (social aid)					
	yes	College	1 888	1 758	618
	yes	University	1 888	1 758	618
	no	College	1 888	1 758	618
	no	University	1 888	1 758	618
15 000					
	yes	College	639	1 758	—
	yes	University	811	1 758	—
	no	College	100	1 758	—
	no	University	311	1 758	—
21 500					
	yes	College	—	1 758	—
	yes	University	—	1 758	—
	no	College	—	1 758	—
	no	University	—	1 758	—
40 000					
	yes	College	—	1 758	—
	yes	University	—	1 758	—
	no	College	—	1 758	—
	no	University	—	1 758	—

Table III.31

Comparison of amounts granted by the student assistance program and by social aid
Couple with one dependent child[1] studying
1983-1984
(in dollars)

	Situation of child		Financial aid granted to student		
Parental employment income	**Student living with parents[2]**	**Level of studies**	**Loan[3]**	**Grant**	**Total**
None (social aid)					
	yes	College	1 195	1 250	2 445
	yes	University	1 620	1 625	3 245
	no	College	1 195	2 760	3 955
	no	University	1 620	3 135	4 755
15 000					
	yes	College	1 195	619	1 814
	yes	University	1 620	1 166	2 786
	no	College	1 195	1 590	2 785
	no	University	1 620	2 176	3 796
21 500					
	yes	College	—	—	—
	yes	University	949	—	949
	no	College	615	—	615
	no	University	1 620	70	1 690
40 000					
	yes	College	—	—	—
	yes	University	—	—	—
	no	College	—	—	—
	no	University	—	—	—

[1] Students considered to be independent are those who are married, have children, have an under-graduate degree or have been on the labour market for two 12-month periods.

[2] The student considered attends a post-secondary institution, except in summer when he is unemployed.

[3] At the college level, the first 1 195 $ is in the form of a loan, while at the university level, loans account for the first 1 620 $.

Table III.31 (continued)

Comparison of amounts granted by the student assistance program and by social aid
Couple with one dependent child[1] studying
1983-1984
(in dollars)

Grants and loans aid				Social aid				Government financial aid for student	
For needs related to studying[4]				For school needs	For essential needs[5]				
					Student dependent on his parents (paid to parents)	Non-student with no income			
Tuition fees	Other expenses	Total	For essential needs	Dependent child		Under 18 (paid to parents)	18 to 29 (paid to non-student)	Needs related to studying	Essential needs
1 175	—	1 175	1 270	35	618	618	1 758	1 210	1 888
1 975	—	1 975	1 270	35	618	618	1 758	2 010	1 888
1 175	1 510	2 685	1 270	35	618	618	1 758	2 720	1 888
1 975	1 510	3 485	1 270	35	618	618	1 758	3 520	1 888
1 175	—	1 175	639	—	—	—	1 758	1 175	639
1 975	—	1 975	811	—	—	—	1 758	1 975	811
1 175	1 510	2 685	100	—	—	—	1 758	2 685	100
1 975	1 510	3 485	311	—	—	—	1 758	3 485	311
—	—	—	—	—	—	—	1 758	—	—
949	—	949	—	—	—	—	1 758	949	—
615	—	615	—	—	—	—	1 758	615	—
1 690	—	1 690	—	—	—	—	1 758	1 690	—
—	—	—	—	—	—	—	1 758	—	—
—	—	—	—	—	—	—	1 758	—	—
—	—	—	—	—	—	—	1 758	—	—
—	—	—	—	—	—	—	1 758	—	—

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4. This amount includes 200 $ for tuition fees and school supplies in college and 1 000 $ in university, and special expenses for board, depending on his parents' financial resources and the student's residence situation. It also includes the costs of housing, meals and transport.

5. The university student is usually over 18 and thus entitled to social aid. The college student is usually under 18 and is not entitled to social aid, unless he was financially independent of his parents.

Furthermore, if a social aid recipient enrols in an occupational training program, 100% of his training allowances will be deducted from his social aid benefits as if it were a question of employment income (except for small monthly exemptions of $25 for a single person and $40 plus $5 per child for a family, with an additional $50 exemption granted to single-parent families for child care). On the other hand, these same allowances do not entitle the recipient to the employment income supplement. Since the difference between training allowances and social aid is very small, the financial incentive to enrol in these programs is also very small, especially if the possible loss of special needs coverage and training-related expenses (transport, clothing, meals, etc.) is taken into account.

The financial incentive for social aid recipients to embark on studies at any level is thus extremely limited. Because of these problems of harmonization, it was necessary to establish special programs to encourage welfare recipients to return to their studies, for instance, those designed to defray special needs related to their education.

3.6.2 The impact of the transfer system on the social and economic behaviour of individuals

The mere existence of the transfer system allows individuals to make choices (to accept work or not) or to adopt a particular form of behaviour which they could not do if this system did not exist. Moreover, since beneficiaries are treated very differently according to whether or not they meet certain standards of health, ability to work, marital status, etc., the transfer system inevitably creates financial incentives to adopt one form of social or economic behaviour rather than another. The impact on labour supply has already been discussed. The impact on family grouping, fraud and failure to claim support will now be dealt with.

3.6.2.1 Impact on family grouping

Among all the measures that may influence beneficiaries' behaviour as to the form of family grouping they adopt, there are three which, apart from being important, are also highly significant with regard to the way individuals may adapt their behaviour to maximize their financial well-being.

First, unlike the tax system which functions on the basis of individual income and which grants exemptions for dependent spouses, the transfer system usually functions on the basis of family income, in other words it takes the incomes of both spouses into account, even if they are de facto spouses. Thus, a social aid recipient may be completely excluded from the program as the result of a remarriage or a new de facto union with a spouse having an income higher than social aid benefits.

Even though it cannot be concluded that social aid encourages the break-up of households, it may nonetheless be thought that if a person is already on social aid (as a single person or single-parent family), he or she will feel a strong financial incentive not to get married officially or to declare a new de facto union, even if the spouse is him/herself on social aid since this program accords a higher income to two single persons than to a couple.

There is no obvious solution to this problem which is inherent in any selective program based on family income. It is hard to apply measures of control in these cases and crosschecking with other program records or income tax returns is unsatisfactory, since the other systems do not recognize de facto spouses. Better integration of the programs and the application of less than 100% reduction rates might nonetheless have a positive impact. Moreover, utilization of scales that were more neutral as regards the form of family grouping or granted the same level of benefits for any kind of grouping, family or otherwise, could also reduce the problem.

A second factor which influences the family grouping of social aid recipients is that the level of essential needs recognized for single persons is higher than for persons living as a couple or in groups. For example, the benefits for a single person between the ages of 30 and 64 represents 62% of the benefits for a couple of the same age; thus the benefits for two single persons represent 24% more than those for a couple (62% + 62% = 124%). This is so because single persons are considered to have additional expenses for housing, furniture, etc.

These different benefits result in a disincentive to living as a couple or a family. One of the solutions to this problem of neutrality might be to not recognize the additional needs for housing and furniture incurred by single persons, which would imply that the additional cost of living alone is a personal choice, not an essential need. It is well known that a large number of single persons do not really live alone, but in non-family households or in rooms. The difficulty with this approach is the non-recognition of what, for some, may be an essential need; it would however place social aid recipients in the same situation as other persons who choose to live alone and must assume the costs.

A third measure which has great influence on family grouping is the measure which consists in reducing by $85 a month the social aid benefits of households who live with a relative in the direct line (father, mother, or child). This measure creates a financial incentive to leave the family home or at least to declare a different address to avoid this penalty.

Once again, the statistics on social aid are very revealing in this regard. Indeed, among young beneficiaries between the ages of 18 and 30, the $85 penalty applies only to the disabled since the benefits for those able to work are already limited to $149 a month. It has been observed that as the penalty rose from $10 in January 1973 to $60 in January 1974 and $85 in January 1975, the rate of residence with a relative, which, in 1975, was approximately the same for those unable to work as for those who were able, moved in the diametrically opposite direction. The rate of residence with a relative went up from 65% in April 1975 to 74% in June 1983 for those able to work, but the rate decreased regularly for those who are not, from 63% to 43% during the same period (Table III.32). The ceiling on benefits for those capable of working may partly explain their higher rate of residence with a relative. However, one may nonetheless question the lifestyle of persons who, on the one hand, are considered incapable of working and who, on the other hand, keep house although inability to work should normally be due to a serious handicap.

Despite all the arguments that can be invoked for or against reducing the level of benefits for persons sharing accomodation, the fact remains that the benefit level must be established in terms of the beneficiary's essential needs. In this respect it must be recognized that the fact of sharing quarters with another person reduces these needs and must be taken into account in establishing benefits, whether the housing is shared with relatives in the direct line or with brothers, sisters or friends.

3.6.2.2 Impact on fraud

As soon as a transfer program penalizes or grants more favourable treatment to a particular group of beneficiaries, depending on whether it meets precise criteria or not (state of health, type of residence, income level, etc.), it creates a financial incentive to fraud.

Table III.32

Evolution of rate of residence with a relative for single persons under 30 receiving social aid
(in percentage)

	18-24 years		25-29 years		Total (−30)	
Month/year	**Able to work**	**Unable to work**	**Able to work**	**Unable to work**	**Able to work**	**Unable to work**
April 1975	70	66	51	57	65	63
December 1975	70	62	55	54	67	58
September 1976	73	57	52	48	69	54
September 1977	74	50	51	44	71	48
September 1978	76	50	54	42	72	47
September 1979	75	48	54	41	72	45
September 1980	74	47	52	39	71	44
September 1981	75	47	53	38	71	44
September 1982	77	48	53	38	72	44
June 1983	79	47	56	36	74	43

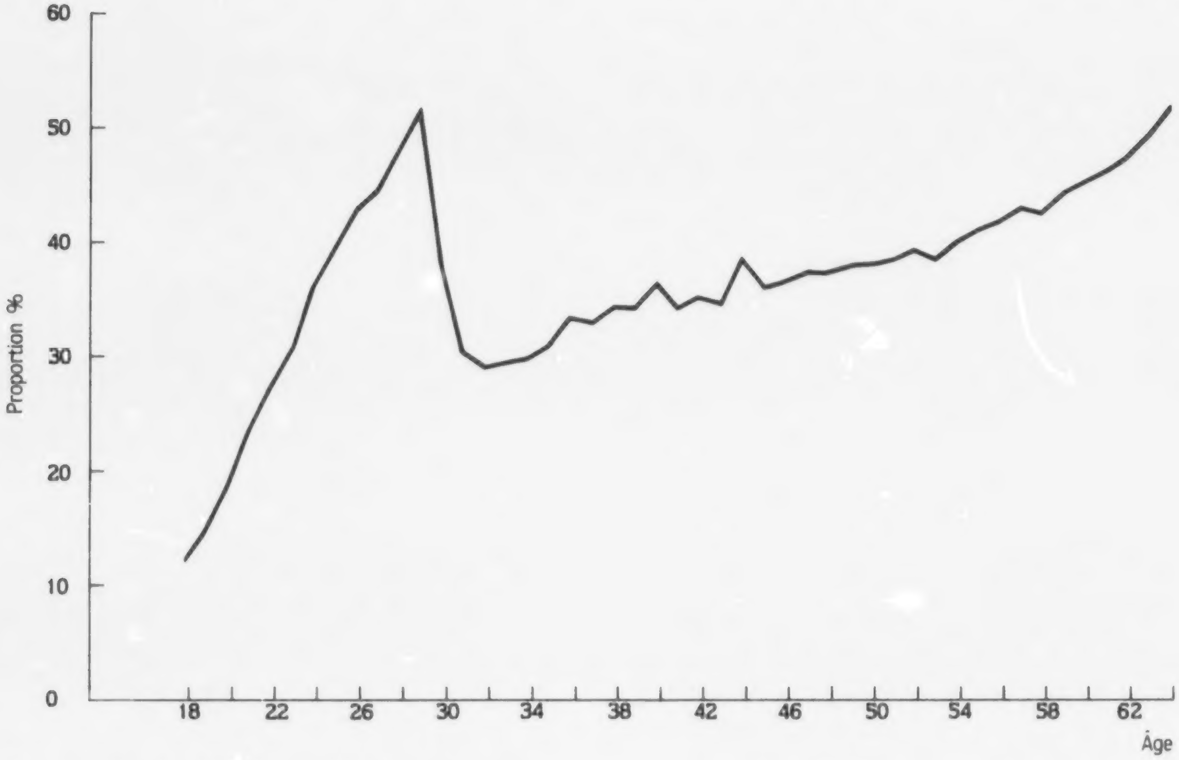
N.B.: The definitions of "able to work" and "unable to work" are not the same as those in footnote 14, Chapter III. Here, "unable to work" is defined more broadly.

Source: Ministère de la Main-d'oeuvre et de la Sécurité du revenu, *Statistiques sur l'aide sociale.*

Graph III.6

Rate of inability to work according to age

Proportion of the disabled among single persons in the social aid program (figures as of September 1981)



Source: *Ministère de la Main-d'oeuvre et de la Securite du revenu.*

Thus, for instance, in 1983, social aid recipients who lived alone and were under 30 years of age received benefits of $149 a month on average if they were able to work compared to $409 a month if they could produce a medical certificate attesting to their inability to work. Over the age of 30, they all received $409 whatever their state of health. However, the rates of inability to work are found to be higher among the under-30s than among those 30 or over, whereas normally, rates of disability for the population as a whole regularly increase with age (Graph III.6).

Although it is impossible to assess the importance of each, there seem to be two explanations for this phenomenon: first, certain beneficiaries incapable of working and 30 years of age or over do not see the necessity of producing a medical certificate since this does not affect the amount of their benefits (so that the real rates of disability over the age of 30 are underestimated); secondly, many beneficiaries under the age of 30 and able to work obtain a false medical certificate to maximize their benefits (so that disability rates under the age of 30 are overestimated). To solve this problem, a medical committee might be set up, as is the case with the social insurance systems (QPP, CSST, etc.) to check the authenticity of medical certificates issued by attending physicians and detect possible cases of fraud. It is estimated that the government would have $30 million less to pay in social aid benefits if the rate of disability among persons under 30 were more in line with the trend observed among those 30 or over.

Another type of fraud arises from the fact that, as in the tax system, beneficiaries of the transfer program and especially of social aid see a disincentive to declare all their income, either official income or under-the-table earnings. A solution to the problem of undeclared official income would be to tighten up mechanisms for crosschecking the records of various government departments and agencies which hold information concerning employment income: the ministère du Revenu, QPP, CSST, etc. As for unofficial earnings, a good way of dealing with the problem is to insist that beneficiaries able to work engage in certain activities such as community work, occupational training or general education to be eligible for higher benefits. The government recently introduced programs for on-the-job training sessions, community service activities and academic make-up courses.

3.6.2.3 Impact on failure to claim support

Under the social aid program, all support income reduces benefits by 100% of the amount received. This does not create much of an incentive for beneficiaries to claim support. For example, there are at present about 78 000 single-parent families on social aid divided into civil status groups as follows: 28 000 unmarried, 6 000 widowed, 20 000 divorced, 7 000 legally separated and 17 000 actually separated. Of this number, barely 11 000 receive support. If we exclude widows and the unmarried, barely 25% of the social aid recipients who might conceivably obtain support from their ex-spouse have actually exercised this right.

The program of support recovery, by which the beneficiary accords the State a subrogation of his recourse, has thus not really achieved its objective, for the subrogration is only possible if the beneficiary gives his consent. It very often happens, for instance, that the beneficiary under a de facto separation refuses to exercise his right to support. There are no obvious solutions to this problem, but it is imperative that one be found, so that the public as a whole is not left carrying an expense burden rightly attributable to a certain group.

3.7 Summary and Conclusion

This chapter has described the main components of Québec's system of transfers to individuals and analysed the problems of integrating this system with taxation. It has also made it possible to grasp the impact of the transfer system on economic efficiency and on labour supply. The main problems of equity arising from the present transfer system were presented and a final section measured the degree of income distribution as well as the impact of the tax and transfer systems on the distribution of income between well-off and disadvantaged households.

However, before drawing conclusions from this chapter, it is important to sum up the arguments developed, while keeping in mind the general, economic and social objectives presented in Chapter I.

3.7.1 The social objective

The social objective consists of two parts: a guaranteed minimum income and an acceptable distribution of income.

3.7.1.1 The guarantee of a basic minimum income

The guarantee that individuals will be able to meet their essential needs forms the basis of the transfer system. With respect to the tax system, the guarantee stems from the fact that the income which provides for essential needs is not subject to tax. As far as the transfer system is concerned, the government's coverage of essential needs has three aspects. First, the government offers the population as a whole services for needs considered to be essential or a priority: education and health care are the main examples. Programs of this nature are not part of the transfer system. Second, general needs regarded as similar for all households of a similar category give rise to uniform benefits which individuals may allocate as they wish for their essential expenditures. Finally, for persons who do not have sufficient resources, certain special needs are covered by refunds to those who show they are eligible.

These special needs are most often specific needs related to health: drugs, dental and eye care, ambulance services, etc. Legal aid needs are another form, as well as housing assistance in the LOGIRENTE program and needs for accommodation in a hostel or home. The objective of covering special needs is intended to recognize the diversity of situations and to adapt to them. However, this poses problems of economic efficiency, for example, the lack of incentive to work on the part of recipients of benefits for these special needs, who lose their entitlement to these benefits when, for example, they come off social aid. It is nonetheless true that recognition of these special needs remains an indispensable tool in guaranteeing a basic minimum income for each individual or household.

As for general needs, the analysis in this chapter shows that the Québec transfer system guarantees a relatively satisfactory standard of living to those benefiting from it. First, the guaranteed basic minimum income is higher in Québec than in Ontario for all classes of households whose head is able to work, except for single persons and childless couples under 30. The application of the Ontario scales to persons able to work in Québec would produce budgetary savings of $150 million. Second, over the past ten years, the standard of living granted to households receiving social aid has gone up more quickly than that of taxpayers earning the average industrial wage, for most categories of households.

Third, the basic minimum income guaranteed by the transfer system ensures coverage of essential needs equal to about 90% of the expenditures for the coverage of essential and important but non-essential needs of households whose income falls in the first decile (10%) and is mainly derived from employment. The study has also shown that, if a certain number of important but non essential needs (transportation, recreation) as well as essential needs whose fulfilment can be delayed (furniture and clothing) are excluded, consumption by these low-income households for the coverage of their needs is about 10% less than that guaranteed by the transfer system. In Ontario, by comparison, recognized essential needs are more in line with the expenditures of low-income households for the coverage of their short-term essential needs. Unmarried persons and childless couples under 30 are exceptions to this because of the lower benefits paid to them.

Another characteristic of the Québec system is to accord as high a level of benefits to those able to work as to those who are not, in contrast with most other systems in the world.

The real consumption of low-income households does not constitute an absolute guideline for the definition of what constitutes the minimum income to be guaranteed by the transfer system. It might be considered, for example, that the standard of living of low-income households is not high enough and should be supplemented by the State. There is no universally accepted definition of what are essential needs and it is therefore impossible to make any absolute statement concerning the degree to which the objective of guaranteeing a basic minimum income is achieved. Comparisons made in relation to the expenditure of low-income households and in relation to what is covered in Ontario show, however, that the Québec transfer system guarantees a higher level of benefits than these standards.

With regard to persons aged 65 and over, however, it is the federal Old Age Security System which plays a major role. The goal of covering essential needs is apparently even better achieved in their case than for the under-65s, since their guaranteed income level is definitely higher. In their case, the role of Québec is limited to the coverage of certain special needs (drugs, ambulance service, accomodation and housing, with the LOGIRENTE program).

For young people of post-secondary age, the transfer system is but slightly harmonized with the scholarships and loans program, offering little financial incentive to young people to continue studying in the short term.

3.7.1.2 An acceptable distribution of income

If we combine a highly progressive tax system with a relatively generous transfer system, the result will inevitably be progressive and appear to effect a relatively high degree of income redistribution. This is borne out by the analysis we have undertaken, which shows that the Québec's personal tax and transfer system is highly redistributive, more so than the Ontario system.

This analysis raises some questions as to the efficiency of the methods employed. Despite the substantial resources allocated in recent years to fight poverty and inequality, income distribution has not improved. The increased transfers to disadvantaged strata of the population have been cancelled out by a decline in their private income. Furthermore, we must ask ourselves whether the system does not provide too much incentive to become or to remain dependent on the State, when it should provide an incentive to re-enter the labour market.

3.7.2 Economic efficiency and incentive to work

The tax and transfer systems pose a number of problems with regard to economic efficiency. But work is surely the form of economic activity least favoured by the personal tax and transfer systems. Even in the best-designed system, income tax cannot treat work and recreation on the same level.

Québec's system presents some serious problems in this area. The marginal income tax rates are very high. In the lower income brackets, benefits are reduced when work income increases — so much so that for the lowest income earners the implicit marginal tax rates generated by the combined effects of rates of taxation and reduction are very high, often above 70%. And when the cost of child care is added, the marginal rates can even exceed 100% when a household uses a non-subsidized day care service, as is usually the case; this means that low-income households have to pay for the privilege of working (see Graphs III.1 and III.2 and Tables III.15, III.16). These rates are distinctly higher than those of which high-income taxpayers complain (maximum 60%). Nevertheless, the impact on incentive to work of marginal income tax rates applied to high-income taxpayers remains considerable.

The harmful effects of these high implicit marginal tax rates do not stem simply from the fact that they change people's preference for recreation. It has already been seen that there are many ways to avoid paying taxes or of suffering a cut in transfers. Domestic production activities (self-supply and barter) are an example. There also working for undeclared income, and tax fraud. These harmful effects are also seen in slackening off at work (taking a less demanding job, or working less hard), and in lack of worker interest in moving to another locality to find work or in getting more professional training.

The high implicit marginal tax rates, then, as can be seen, give rise to a series of more or less effective activities, thereby lowering the standard of living which a society might attain, and reducing the tax base even more. The quantification of this phenomenon provided by the general equilibrium model of the economy suggests that the economic loss brought about by the tax and transfer systems (both Québec and federal) can amount, depending on the hypothesis considered, to between 15% and 35% of Québec's net domestic product. Such a withdrawal of income cannot help but have a negative impact. Nonetheless, close attention must be paid to this impact when choosing fiscal measures.

3.7.3 The objective of equity

The multiplicity of components in the tax and transfer systems makes it difficult to attain the objectives of equity and simplicity. The various elements are not perfectly integrated. This can lead to certain needs receiving duplicate coverage while others are covered inadequately. Lastly, the application of different concepts of income, assets, household, base period and needs to be covered adds to the problems of integration and equity in the tax and transfer systems.

The tax and transfer systems are also unfair in the way they over-assess or under-assess the ability to pay of various categories of taxpayers. This is true first of all with respect to the transfer system, which does not cover essential needs sufficiently in certain cases (e.g. single persons under 30 years of age without families), and covers them to excess in others (e.g. property taxes for social aid recipients). We have also seen how it is almost always financially better to be on social aid than studying, and that the guaranteed basic minimum income of persons 65 or over who have never contributed to the Québec Pension Plan is 25% and 40% higher than the guaranteed income of persons between 30 and 64 years of age, single and married respectively.

And exactly the same problem exists with regard to taxation. A household's ability to pay taxes, normally equivalent to the income in excess of essential needs, is not accurately measured, because essential needs are also ill defined. A number of personal exemptions do not correspond with the essential needs attributable to persons for whom they are claimed in any household. To begin with, it is not certain that essential needs of single people are accurately measured when these people are imputed all the costs related to the upkeep of an apartment, where as in fact, 70% of all single people live either in rooming houses or with other adults in an apartment. Problems of equity also arise in the matter of essential needs of the elderly, and those of families where (1) both spouses work in the labour market and (2) only one spouse does so; the discrepancy between the married person's exemption and the basic exemption, and the choice of tax unit, gives an advantage to couples where both spouses work, particularly those where there is no child and income is high. The fact that there are several levels in the tax table adds to the problem.

Nor are the personal tax and transfer systems fair to those who are responsible for children compared to those who are not. The first objective of compensation for family responsibilities is to take account of the reduced ability to pay of households with dependent children. It can also be envisaged as helping those with the care of children to join the labour force. In the first case, compensation is universal: only related to the presence of dependent children; in the second case, it is also linked to participating in the work force. Among the first type are personal exemptions, family allowances and availability allowances, which were considered in Chapter II; among the second type are subsidies and deductions for child care costs.

An analysis of this question shows that the second category — assistance intended to help people enter the labour force — has until now been neglected. The tax deduction for child care costs can easily take account only of two thirds of the costs actually incurred for the care of pre-schoolers. The grant is awarded only to those households which make use of licensed day-care centres, and thus is provided for only 13% of those children who would otherwise be entitled to it if it applied to all types of care. Moreover, a sizable proportion of this assistance is paid out to households already receiving social aid and which are not part of the labour force.

Finally, the income tax system is not fair to students. Their expenses are not well recognized by the taxation system, which allows only tuition fees to be deducted. And this deduction cannot even be transferred to the person deemed to have responsibility for the student under the student assistance program, nor can it be carried forward if it cannot be used in the current year.

3.7.4 Administrative simplicity and ease of comprehension

The personal tax and transfer systems have become increasingly complex over the years. New programs are constantly being added, and the legislation, regulations and procedures are constantly growing. In many cases, people must apply to several organizations to obtain transfer payments for the same purpose. Consider the plethora of different agencies paying out amounts for dependent children. The reform will have to pay more attention to simplifying things.

Greater coordination of all the elements of the tax and transfer systems would surely have beneficial effects at this level. Such coordination would also have the advantage of simplifying administration and reducing costs. It would also make it possible to reduce tax evasion and fraud. The overall reform should make the personal tax and transfer systems more acceptable to taxpayers and increase their desire to comply with them.

Part Two

Proposals for Reform

General Outline of the Reform of the Personal Tax and Transfer System

Chapter IV
General Outline of the Reform of the Personal Tax and Transfer System

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Chapter IV

General Outline of the Reform of the Personal Tax and Transfer System

Chapters I, II and III dealt with personal taxation and transfers to individuals; they described the problems which arise in this area, based on the objectives to be pursued and constraints which must be taken into account. The following four chapters discuss in detail the solutions to be implemented.

Prior to examining these solutions, it is important to first thoroughly explain and properly summarize the general outline of the reform. Any basic reform must be supported by a number of main themes to ensure that its various elements harmonize with each other.

Such themes obviously arise from the problems identified, although they are also related to constraints related to solving problems, the objectives sought by a society, and the choices made in this context among the various means available to correct the system.

After dealing briefly with the political framework of the reform and its cost, this chapter presents a broad outline of the reform of the personal tax and transfer system. With respect to each orientation, the goal or goals pursued are identified, as well as the strategy envisaged, and the main effects anticipated.

The chapter then goes on to answer the following question: how will the reform be financed, and who will benefit most from it? The purpose of this chapter is to succinctly outline the reform; the last three chapters will describe in much greater detail its various elements, and how it will affect the financial situation of households and the government's financial framework as well the creation of employment and distribution of income.

4.1 The Political Framework of the Reform

Given the government's policies and the extent of the problems to be solved, it would be illogical to envisage the reform of the **tax** and **transfer systems*** within an exclusively federal framework. The principles underlying the present reform correspond to general considerations which are valid as much, if not more, from the point of view of sovereignty rather than federalism. The proposed reform is more an overview of Québec society than a simple, immediate adjustment of the tax and transfer system applied by one level of government or the other. This does not prevent the essential aspects of various proposals from being implemented under the current framework; however, it is to be hoped that the federal government will also modify its tax and transfer system and transfers to the gouvernement du Québec on the basis of this conception of Québec society's needs.

4.2 The Cost of the Reform

The reform cannot be implemented at no cost to the government, even under the existing political framework; otherwise, it would be a question of taking away from some people to give to others. The objective is rather to allocate most of the financial leeway to certain groups — not necessarily all of them — to satisfy goals respecting economic development and social fairness. Under all the options outlined in the following chapters, the gouvernement du Québec anticipates that the total net cost of the reform will be about $600 million. However, part of the cost will be borne by the federal government, with the result that, under the reform, the **net contribution** of Québec households to the financing of government expenditures could fall by between $800 million and $900 million.

It must be noted that the cost of the reform is calculated in 1983 dollars, which means that the amounts just mentioned do not reflect the impact of a number of measures implemented since then. These include, for example, the three assistance programs for social aid beneficiaries under 30 introduced in early 1984 under Québec's economic recovery plan. The fact that such measures are already in effect will reduce the cost of the reform as described in the *White Paper* to the Québec and federal governments.

It may be asked to what extent the gouvernement du Québec will have sufficient leeway to fulfil such an objective in the coming years. The answer is that if the results of the reform are as expected, a substantial part of the funds to be allocated to it will be recovered in the form of additional tax revenue, especially through an appreciable increase in economic activity and employment (see Chapter VI).

Second, there is no obligation to spend the full amount during any one year. In particular, a number of the costliest measures related to social transfers may be spread out over a period of time; indeed, it would be preferable to do so. It should be remembered that some of the measures designed to enhance "employability" set out in the present reform (community work, on-the-job industrial training, resumption of studies, and so forth) are already being tried in 1984, and are pilot projects whose results will have to be analysed before the **transfer system** is reformed further.

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* Terms in boldface type are defined in the glossary.

4.3 General Outline of the Reform

Three reform options are proposed in the *White Paper*, presenting different combinations or implementations of the measures described below in response to various objectives. The general outline of the reform is laid out in the following ten subsections. The final subsection summarizes the measures under consideration with a brief description of the content of each of the reform options.

4.3.1 Incentive to work

As was explained earlier, the most important economic problem engendered by the personal tax and transfer system is that of substantially reducing the incentive to work and become a productive element in society. There is no doubt that one of the basic concerns of the *White Paper* and the reform resulting from it must be to increase the incentive to work, to seek vocational training, and improve the socio-economic well-being of households. This entails encouraging individuals and families to assume responsibility for themselves, rather than increasing their dependency on the government.

It is not normal for the government to take away the greater part of additional income earned by a worker when he finds employment, as is the case under the current system. As was noted in preceding chapters, the situation is especially critical for low-income earners, although it also adversely affects middle and high-income earners.

With respect to those with high incomes, it is frequently said that income tax is so high in Québec in relation to that paid elsewhere in North America — particularly in Ontario — that it hinders the recruiting of senior management personnel and specialists. This notion has been so widely disseminated in Québec, and outside it, that, without its being clear to what extent it is true, its anticipated effects have, to some extent, been felt. However, as was noted in Chapter II, the cost of living for most households, even when taxes are included, is lower in Montréal than in Toronto and other major Canadian cities.

Reducing the **tax burden** of high-income taxpayers is essential, in any case, not only to increase the incentive for them to work, but to ensure that Québec's comparative advantage with regard to cost of living is not reduced or obviated by overly heavy taxation. This advantage must be employed as an instrument of economic development for Québec. If, moreover, this were to help discredit the notion mentioned earlier, an additional step in the right direction will have been taken.

The effects of an excessive tax burden and **marginal income tax rates** on middle-income earners have been less publicized. Nonetheless, Québec's economic future is closely tied to this group. We must maximize the incentive to work and become productive to enable Québec society to more fully benefit from the potential of its labour force, and, in this manner, take advantage of extensive efforts made in the realm of education.

For middle and high-income taxpayers, an increased incentive to work must be achieved by the adoption of the following measures: a reduction in marginal income tax rates, and more equitable consideration of employment expenses under the tax and transfer systems. In this regard, there is every reason to revise the current general employment expense deduction, and modify child care expense deductions in order to take into account expenses actually incurred.

At the bottom of the income scale, the problem of the incentive to work becomes more complicated. Taxes are not the only factor, as **transfer programs** also play a part. It follows that the **implicit marginal tax rates** which apply in this category of income are extremely high; occasionnally, they are tantamount to the confiscation of income. For example, it has been noted that the net gain of the head of a family with two children, after he has paid income tax and lost part of his benefits, is between $0.83 and $0.85 an hour when he finds employment at the minimum wage. The manner in which taxes and transfers are **integrated** or, more precisely, the manner in which they are not integrated, must be subject to thorough review. Integration of the tax and transfer systems is one of the basic principles underlying the reform. In addition, grants for child care expenses must also be changed to ensure that the presence of children does not pose an insurmountable obstacle to seeking employment, particularly among single-parent families.

4.3.2 Coverage of essential needs

It should be remembered that the social objective consists of attaining an acceptable **redistribution of income**, and that one sub-objective of vital importance consists of ensuring that no taxpayer's health or dignity is threatened because he lacks the means of subsistence. To do so, it is first necessary to determine which needs are essential and the minimum income required to cover them.

In this respect, poverty levels have, until now, been defined in a more or less arbitrary fashion, without referring to the actual standard of living of low-income earners, that is, without taking into account the possibility of a choice between financial independence, and social aid beneficiaries' dependency on the government. The reform will also review the norms employed to define essential needs, to ensure that they reflect expenses actually incurred by low-income households, whose principal source of income is employment, to satisfy such needs. The necessary data are provided by a Statistics Canada study respecting family expenditures.

Once basic needs have been determined, there are two ways in which society may ensure that all citizens obtain them. The first, and best known, is to make up the difference, by means of transfers, for all those who are unable to obtain this basic minimum income on their own. The second consists of not taxing minimum income devoted to covering essential needs. In the first instance, the transfer system must play this role; in the second, it is the tax system which must be adjusted accordingly. This end may be attained by making personal exemptions equal to the essential needs of those who are recognized as being the most underprivileged, and by refunding **property** and **consumption taxes** on essential needs through the appropriate **property tax** and **sales tax credits**.

4.3.3 A more efficient means of combatting poverty

The objective of encouraging low-income earners to work is more than a measure related to economic efficiency. It is also a way to combat poverty, and attain the social objective respecting greater equality in income distribution.

As was noted earlier, it is becoming increasingly evident that the strategy for combatting poverty must be completely changed. The current approach, which consists of automatically paying benefits to all those below the poverty line, as defined by the government, is becoming increasingly inefficient and costly. It creates a relationship of dependency between social aid beneficiaries and the government which, in the long run, ultimately reduces the standard of living which most of them might have attained. In a society where the work ethic remained strong and the social constraint was greater, such a system would be more readily imaginable: the financial incentive to deliberately opt for dependence was amply counterbalanced by sanctions of another nature.

Given the manner in which society has evolved, this approach is becoming increasingly intolerable. The strategy for combatting inequality must now place greater emphasis on means to help the most underprivileged improve their lot and break out of the ghetto of poverty, rather than on means which result in greater dependency on the government. This change of policy related to combatting inequality must include a thorough review of the transfer system applied in Québec, and choices related to it.

It is not just the incentive to work which must be increased, but the incentive to undertake steps to enhance one's "employability", including further studies, training, community work, and so forth. Various programs in this area must lead the most underprivileged to take charge of themselves and decide which **reintegration activities** will improve their chances of finding employment. The government's role consists mainly of ensuring technical and financial support for such activities; those covered by the programs are responsible, first and foremost, for taking the initiative.

The principle of the financial independence of the beneficiaries of such programs raises sensitive questions. Must the government unconditionally insure coverage of the essential needs of all those between 30 and 64, and of heads of families (with children) who are considered able to work, as it does at present? Or, should beneficiaries be required to make a minimum effort in terms of participating in activities designed to enhance their "employability"? The *White Paper* outlines two approaches in this respect, and invites Quebecers to express their opinions on this matter. The first, more traditional, approach (option I), grants the same level of income to those who are available for reintegration activities as to those who are not. The basic minimum income guaranteed by option I corresponds to that paid under the current social aid program, that is, the equivalent of **short** and **long-term essential** needs. Options II and III are also designed to provide a level of income which is sufficient to satisfy short and long-term essential needs. In return, however, they require that beneficiaries remain active by participating in activities which improve their chances of successfully reentering the labour market, or by working on a part-time basis. Under the proposed system, options II and III would apply new penalties, which would reduce benefits to the level of short-term essential needs for beneficiaries able to work but who are not available either to undertake a reintegration activity or to search for employment. As benefits which would be paid to persons who are available to participate in a reintegration activity, they would remain at their current level following the initial implementation of the reform until they matched the level of their short-term essential needs plus clothing needs.

However, it is obvious that this change, were it to occur, could only be undertaken gradually, and should take into account conditions on the job market and the ability of reintegration programs to absorb individuals who wish to participate in them. Constraints appear in a striking manner with respect to the pace at which this transfer policy is applied. Although an attempt would be made to encourage social aid beneficiaries and, generally speaking, the unemployed, to improve their "employability" and seek employment, account must be taken of the job market and the development of training programs. This implies that, until the employment situation has improved considerably or until reintegration activities are widely available, the measures suggested by the *White Paper* will be introduced gradually, but without penalizing those who are receiving social aid benefits and cannot find employment. In this regard, the measures announced in the economic recovery plan in November 1983 to encourage social aid beneficiaries under 30 to find employment already testify to the importance of this orientation, and may serve as an ideal proving ground for the entire reform.

4.3.4 Household makeup

The tax system is far from being perfectly fair to each category of taxpayers. In particular, as was shown in the preceding chapters, the manner in which households are taxed varies enormously according to the type of household, or the way in which the household is organized. The tax reform cannot avoid this question, all the more so as such orientations also exist under the transfer system; it is essential to better coordinate both systems.

Under any personal income tax system, **personal exemptions** or tax credits are used to reflect the diversity of domestic situations. Benefits such as family allowances may complement the system; they are similar to tax credits, as they provide the taxpayer with a benefit, regardless of income.

Under the proposed reform, it is essential to decide which method of taking essential needs into account is the fairest: personal exemptions, tax credits or allowances?

As was noted earlier, the purpose of personal exemptions is to avoid taxing that part of income which covers to the taxpayer's and his dependents' essential needs. The principle of not taxing such income implies maintaining the current system of personal exemptions, rather than adopting a system of tax credits. The system of personal exemptions alone makes it possible to avoid taxing income which corresponds to essential needs without engendering excessive costs for the government. On the other hand, tax credits have the advantage of encouraging a certain degree of financial autonomy among dependents, when the latter receive cheques directly.

With respect to dependent children, an approach based on exemptions entails a change in policy, as current family allowances are comparable to a tax credit. This is a choice which will have to be made; the *White Paper* submits both alternatives for discussion, as well as a mechanism for maintaining existing family allowance rights under a system of exemptions.

The level of existing personal exemptions must be adjusted to better correspond to the essential needs of the taxpayers they cover. For example, a household in which only one spouse works outside the home benefits from total personal exemptions below those in a household where both spouses work. There is no reason for this state of affairs to continue; the tax reform will establish the equivalence of exemptions for a couple, whether one or both spouses earn income, and whether the spouses are married or a de facto couple.

A second problem related to the recognized needs of children, which are insufficient, whether covered through personal exemptions or family allowances. Moreover, as was mentioned earlier, the child care expense deduction is too high for school age children but inadequate for pre-schoolers; this deduction should be modified to take into account child care expenses actually incurred. The same applies to the child care grant, which must be expanded to encourage the second spouse of a two-parent family and, in particular, heads of single-parent families to seek employment and attain financial independence. This explains why a considerable part of the benefits of the reform are allocated to families.

4.3.5 The tax table

The principles just outlined will result in a tax table which is appreciably different from the current one. First, we must ensure that taxes are only paid when the individual or the family no longer receives government transfers to cover essential needs. Thus, the floor on taxable income must be raised. In this way, the income earned by those obtaining employment will not be doubly taxed, through a tax increase combined with a reduction in transfers.

The zero tax threshold will be raised using a **lump-sum tax reduction**. As a result of this operation, the new tax table will begin with higher rates than the old one, without resulting in a loss to taxpayers.

However, care must be taken to ensure that, overall, marginal tax rates remain lower than they currently are, with a view to fostering the basic policy of providing a greater incentive to work throughout the income scale. Thus, the tax table will be rectified to make it less **progressive** with regard to middle and high incomes, reaching a lower maximum marginal rate than exists at present. Given the tax advantages provided by the Stock Savings Plan in Québec, a reduction from 8 to 10 percentage points in the disparity between the maximum marginal rates in Québec and Ontario may prove to be satisfactory. One of the reform options provides for reducing this gap to 6 percentage points.

Chapter VI indicates the impact of these changes on **implicit marginal tax** rates and the **average tax rates** which apply to various categories of taxpayers. However, a summary of the reform's impact by main income groups appears at the end of this chapter.

The broad orientations just outlined apply to the reform overall. A number of other points apply to more specific aspects of the reform and to precise groups of taxpayers.

4.3.6 Assistance for low-income earners

According to the *White Paper*, it is essential that social aid beneficiaries (and, under a different political framework, the unemployed) be encouraged to find employment and, as a result, increase their **disposable income**. Similarly, low-income earners must be encouraged to keep their jobs and attain, at all times, a satisfactory level of available income, through transfers if need be.

An employment income supplement exists under the current system, although it only applies to beneficiaries between 30 and 64, or younger ones with children. Moreover, benefits under this program generally apply to levels of income on which tax is payable, thus reducing or obviating the benefits of this supplement. Assistance for low-income earners must be made more effective. First, no tax should be collected as long as such households are receiving transfers. Government assistance should not be completely withdrawn until they attain a sufficient level of income. Such assistance, which constitutes a supplement to the households' employment income, must be added to the direct incentive for social aid beneficiaries to seek employment, so that they benefit substantially from the pecuniary rewards of finding employment. The formula developed in the *White Paper* seeks these objectives by extending the employment income supplement to wage earners under 30, and, insofar as it is possible to do so, by allowing low-income earners to keep a greater part of their income. Considerable funds (between $260 million and $380 million, according to the option chosen) will be allocated to bolstering the employment income of low-income earners.

4.3.7 Assistance for improving "employability"

This measure is directed to those who depend on government assistance to cover their essential needs and who, despite the increased incentive to work, are unable to find employment. At present, several Québec job creation programs give priority to social aid beneficiaries. However, the policy of creating jobs for social aid beneficiaries is a facet of general job creation policies, and only succeeds in reaching a small proportion of social aid beneficiaries. Under its economic recovery plan, the government changed this perspective and centred its initiatives on enhancing beneficiaries' "employability". Three programs (community work, the resumption of studies and on-the-job industrial training) have been implemented for social aid recipients under 30. Budgets of $115 million in 1984-1985 and $133 million in 1985-1986 have been allocated; it is expected that 50 000 such recipients will be affected by the programs.

The underlying principle in these programs is that benefits for all those who engage in such programs will be increased. As the administrative means for organizing these activities are developed, they will gradually be extended to cover all social aid beneficiaries. Under this program process of reintegration into the labour market, priority is given to those under 30 as the social aid program does not currently cover their essential needs.

In the *White Paper*, the implementation of these programs implies establishing a distinction, among people 30 to 64 and those under 30, between those who are able to work, and those who are unable to do so, as measures designed to enhance "employability" only apply to those who are able to work. Indeed, it is proposed that the current social aid program continue to apply to those who are unable to work. On the other hand, a completely new income guarantee program will be offered, and will apply to people who are able to work. Those who are considered unable to work who wish to do so may participate in it. In the latter instance, it will be much easier to establish the most efficient procedures for encouraging beneficiaries to return to work.

4.3.8 Importance of consumption taxes

The problems outlined in Chapter II led us to observe that, compared with Ontario, Québec taxes production relatively more than consumption. This situation creates a greater disincentive to work and produce in Québec. In this respect, option III advocates more extensive use of sales taxes as a means of reducing income tax, thereby encouraging production activities which create employment.

By broadening the sales tax base to cover all consumer goods, except for food, prescription drugs and professional services, option III would make it possible to recover about $900 million, which could be allocated to more substantial tax reductions. It would thus be possible to considerably improve economic efficiency through a greater incentive to work, without affecting the government's budgetary leeway.

The problem with such an approach lies in the regressive nature of consumption taxes. It is necessary to avoid implementing such a tax reform to the detriment of those who spend a considerable part of their income on consumption, that is, low-income earners. It is proposed as part of the reform that a sales tax credit be implemented, which would provide a refund sales tax paid by low-income earners on goods to cover their essential needs. Similarly, a property tax credit would also be established. These tax credits would, of course, be greater under option III.

4.3.9 The elderly

The *White Paper* does not reduce the tax burden of the elderly. Indeed, it increases it, even in the case of those who continue to work after the age of 65. The situation outlined in Chapter II does not justify taking a different approach. Improving the lot of the most underprivileged among the elderly must be carried out on the basis of a different set of premises, which lie beyond the scope of the *White Paper*.

4.3.10 Single-parent families

With respect to the manner in which single-parent families are taxed, the reform proposes an alternative. The first facet of this alternative is related to the current situation and is based on the same principle of equality of essential needs between a single-parent family with a child, and a childless couple. The second is radically different from the first in that it accepts the principle of a lower exemption and lower benefits for children[1], but makes more generous allowance for child care expenses incurred in order to pursue studies, on-the-job industrial training, or to hold a job.

The second approach is obviously much more dynamic, and offers a much greater incentive to work. It encourages single-parent families to be less dependent; it also has the advantage of being more **neutral** and treating single and two-parent families uniformly. Despite these advantages, the reform does not exclude the more traditional approach: Quebecers must discuss the matter and make a decision.

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[1] Rather than granting the first child essential needs equal to those of an adult, he will be granted essential needs equal to 150% of those of the first child in a two-parent family.

4.3.11 The need for several options

The reform options under consideration will be described in detail in Chapter V, although it is important to immediately point out the fundamental difference between the guiding principles of options I and II, and the substantial changes implied by option III.

Of the three options in question, option I is more traditional, and is essentially aimed at protecting income, rather than encouraging people to work. It virtually represents the status quo in terms of transfers since its benefits do not depart significantly from those currently in effect, and automatically cover all essential needs, whether short term or long term. Contrary to the other options, beneficiaries are not required to participate in activities designed to enhance "employability".

Given the constraint the government has imposed on itself in terms of cost ($600 million), maintaining a high level of benefits makes it necessary to more quickly reduce benefits under the income guarantee program as soon as employment income is earned. Under option I, the amount granted in transfers to a wage earner who finds employment will have to be reduced by $0.67 per dollar earned.

Options II and III provide a greater incentive to work by enabling the wage earner to keep more of the additional employment income he earns. These options provide benefits which correspond to the expenditures of low-income households for the satisfaction of their short-term essential needs, by way of a reworking of the existing system of penalties, to those who are neither available for work nor for reintegration activities. This makes it possible to reduce the **marginal transfer reduction rate** under options II and III to 50% when employment income increases.

Options I and II do not lend themselves to the attainment of all aspects of the reform. The leeway created only makes it possible to reduce the maximum marginal tax rate from 60% to 58%. Moreover, even under option II, the objective of increasing the incentive to work is not reached to the extent hoped for, since the marginal rates of middle-income earners are not reduced, although their tax burden is lightened as a result of the lump-sum reduction in taxes.

In order to push further ahead in elaborating the policies to be pursued, the *White Paper* is proposing option III, which includes an "internal" source of financing. This option derives an additional cushion of $900 million from the sales tax base, through the abolition of most of the exemptions under it, except, in particular, on food and prescription drugs. Moreover, it implies a major change in government policies pursued up until now with respect to the sales tax.

This new cushion of $900 million may be used to increase the incentive to work, and further reduce taxes by further reducing the marginal rates for all taxpayers.

Option III makes it possible to pursue various aspects of the reform to the fullest extent. However, it may prove to be painful for low-income earners because of the regressive nature of consumption taxes. This problem could be rectified through the introduction of a sales tax credit, the purpose of which would be to refund sales tax paid on the purchase of goods required to cover essential needs.

Each of the three broad options put forward has advantages and disadvantages; each makes it possible to pursue the main facets of the reform to varying degrees. Given the reform's strategic importance for Québec society, it is important that a public discussion be held on these options before a choice is made. To better situate what is at stake, the last three chapters describe in detail different aspects of the proposed reform and the basic choices it implies, and discuss the impact of the reform on the extent to which the objectives sought are attained.

4.4 Sources of Financing and Utilization of Funds

Implementing the reform will require extensive changes in the tax and transfer systems. Some existing programs will be abolished, while others will be implemented. For example, the employment income supplement will be completely integrated into the new income guarantee program for those who are able to work.

The amounts in question are also substantial. Changes in the marginal rates and the new lump-sum tax reduction will cost between $500 million and $1 250 million, according to the option chosen. Moreover, financing retraining activities might cost as much as $500 million, if funds already allocated to such activities under the economic recovery program are included.

With respect to taxes, the total cost to the government of the changes made would vary between $350 million and $450 million, according to the option selected. Once the system has been implemented, on the basis of the financial leeway available it would be possible to increase tax reductions from year to year. The **indexation** of personal exemptions must undoubtedly be maintained, although nothing would prevent a concomitant reduction in personal income tax. At least, a coherent framework for proceeding will have been established.

As for social transfers, their increased cost may be surprising, as it is similar to the cost to the government of reducing taxes. This increase, as outlined in the *White Paper*, would total between $300 million and $500 million. Within the context of the reform, the cost to the gouvernement du Québec is less than these sums. There are two reasons for this state of affairs.

On the one hand, part of the necessary funds have already been incorporated into the 1984-1985 budget, and the forecast financial framework for succeeding years. In 1985-1986, $133 million has been allocated to covering the cost of the three programs intended to encourage social aid beneficiaries under 30 to return to work; the actual increase in anticipated transfers is $133 million below what has been calculated based on 1983 figures. A considerable part of the funds required should normally be shared equally by the Québec and federal governments. Under the circumstances, leeway of between $100 million and $200 million would be needed to finance the increase in **transfers** to individuals under the reform.

Table IV.1 indicates where funds will come from and how they will be spent in relation to the programs which are introduced, abolished or changed. It will be noted that the costliest policies deal with the incentive to work and the reduction in the tax burden. On the one hand, the increase in tax deductions for employment expenses (general employment expense deduction, and child care expense deduction) total $230 million. With regard to transfer programs, the supplement granted for activities designed to enhance "employability" represents between $300 million and $500 million, while the income supplement paid to low-income earners represents an additional $250 million to $400 million. The drop in taxes will cost between $350 million and $1 350 million, according to the option chosen.

Table IV.2 indicates who will actually benefit from the reform. The first and most important beneficiaries will be couples with children, as about 40% of the funds allocated will be directed to this group of taxpayers. More equitable consideration of the essential needs of dependent children and the amelioration of the deduction for child care expenses explain this result. Most beneficiaries are couples with children, earning less than $30 000. About $125 million will be allocated to social aid recipients, the same amount to those earning between $15 000 and $30 000, some $325 million to those who earn less than $15 000, and $160 million to those who earn more than $30 000.

The second group of beneficiaries is made up of single people earning less than $15 000; it includes many individuals under 30 who only work sporadically. The new transfer system grants them an extremely valuable advantage.

The third most important group is couples with children and single-parent families benefiting from social aid. The increased grants for child care expenses will prove to be a source of considerable income for these families.

Among the other groups, the funds allocated are less considerable, which may be attributable to the fact that they are numerically less important, or because the group was already favoured under the current tax and transfer systems.

Table IV.1

Financial impact of the reform
Sources of financing and utilization of funds
(in millions of dollars for 1983)

	Option I	**Option II**	**Option III**
Sources of financing			
▪ Québec government's leeway	616	603	605
▪ Federal transfers	259	167	189
Total	**875**	**770**	**794**
Utilization of funds			
Changes in income tax			
▪ Changes in personal exemptions[1]	−326	−326	−261
▪ Changes in the manner in which children's essential needs are taken into account	99	99	153
▪ Increases in employment deductions (including child care expenses)	230	230	220
▪ Changes in the tax table (including the lump-sum tax reduction)	493	567	1 256
▪ New system of credits for property and sales taxes	−35	−35	87
▪ Miscellaneous	−91	−85	−82
Subtotal[2]	370	450	1 373
Changes in sales tax	0	0	−936
Change in transfer programs			
▪ Beneficiaries who are not working			
— Changes in ordinary benefits and non-availability	−108	−333	−295
— Remuneration for reintegration activities	306	478	478
▪ Low-income earners	392	260	260
▪ Miscellaneous[3]	−85	−85	−85
Subtotal[2]	505	320	357
Total[4]	**875**	**770**	**794**

1. Including the 100 $ general deduction.

2. The total of the impact of changes in income tax may differ from tables in Chapter VII because family and availability allowances paid to households benefiting from transfers have been accounted for in this table in the impact on transfers, rather than on taxes.

3. Including the amount of family and availability allowances paid to households receiving transfers, which have been included in this table under the impact on transfers rather than under the impact on tax.

4. The total amount represents the overall gross cost of the reform for the gouvernement du Québec and the federal government. It also represents the gain made by all taxpayers in terms of reduced net contribution to the financing of public expenditures.

Table IV.2

Impact of the proposed options on various types of households
(in millions of dollars)

Households	**Single persons**	**Single-parent families**	**Childless couples**	**Couples with children**	**Elderly persons**	**Total**
Households receiving social aid under the existing program						
• Option I	(12)	78	21	69	—	156
• Option II	(36)	60	15	66	—	105
• Option III	(41)	60	14	73	—	106
Number of households concerned	247 800	78 700	22 900	45 700	—	395 100
Households with income under 15 000 $						
• Option I	338	8	29	50	7	432
• Option II	270	5	27	33	9	344
• Option III	245	10	15	42	1	313
Number of households concerned	655 900	55 000	63 200	87 100	221 800	1 083 000
Households with income between 15 000 $ and 30 000 $						
• Option I	(3)	(6)	36	91	5	123
• Option II	5	(5)	48	112	9	169
• Option III	18	(7)	33	87	—	131
Number of households concerned	326 200	38 000	158 400	306 000	68 400	897 000
Households with income between 30 000 $ and 50 000 $						
• Option I	1	(2)	18	70	1	88
• Option II	(2)	(2)	20	73	1	90
• Option III	17	(1)	29	69	1	115
Number of households concerned	68 000	9 500	128 300	275 700	16 200	497 700
Households with income over 50 000 $						
• Option I	6	1	19	51	3	80
• Option II	5	1	15	42	2	65
• Option III	14	2	45	60	9	130
Number of households concerned	11 500	1 900	44 300	99 300	11 500	168 500
All households						
• Option I	330	79	123	330	15	875
• Option II	241	59	125	327	21	770
• Option III	252	63	138	331	11	794
Number of households concerned	1 309 400	183 100	417 000	813 800	317 900	3 041 300

N.B.: As figures have been rounded off, totals may not correspond to the sum of various elements.

4.5 Conclusion

The reform is an ambitious one, and the problems to be solved are extensive. Québec's economic future and the kind of society we will live in depend essentially on our ability and willingness to solve these problems. It is for this reason that it would have been pretentious, if not pointless, in this *White Paper*, to propose only one solution to the problems outlined. It is important to present a series of solutions which correspond to a number of objectives and choices for society, on which Quebecers will express their opinions. The government will, however, indicate its own preferences at the conclusion of this document, bearing in mind what changes it feels society is ready to accept.

Such a discussion must dwell on the types of tax and transfer systems which will apply when the reform has been fully implemented; it is in this perspective that the proposed options and their results are presented. However, it is obvious that a reform of this scope cannot be implemented overnight. First, the necessary financial leeway can only be obtained gradually, that is, as economic growth provides the resources needed to implement the reform, without increasing the tax burden.[2] It must be understood that the objective of encouraging social aid beneficiaries to seek employment represents not only a major challenge with regard to the administration of a transfer program, but an objective whose attainment will be affected by the current economic situation, and the job market. A gradual approach is necessary in this area. It must be pointed out that the process of reforming transfers has already been undertaken with the introduction of three programs designed to increase the "employability" of young social aid recipients. These programs are pilot projects whose results may indicate to the government the course to be followed in implementing the reform of transfers with respect to all beneficiaries.

It is to be expected that the next initiatives to be taken in implementing the reform of taxation will concern the tax system. The reform of transfers and its integration into the tax system would be pursued following the introduction of programs designed to enhance "employablity", according to changes in the employment situation.

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[2] More precisely, it is the part of economic growth which equals economic growth registered in the five provinces used to calculate basic **equalization** payments which may entitle the government to such a dividend.

The Proposed Reform

Chapter V
The Proposed Reform

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Chapter V
The Proposed Reform

Chapters II and III gave a description and analysis of the problems created by Québec's tax and transfer systems as applied to individuals. Sections 2.4 and 3.7 presented a summary of the analysis and its principal conclusions. Chapter IV discussed the broad themes and general outline of the reform of the personal tax and transfer systems.

The main framework of the reform is presented in Chapter V, showing the options that can be considered throughout the income scale. Particular aspects of the reform options are then broached. The final section sets out the terms of the options. The effects of the reform will be illustrated in Chapter VI, and the fundamental choices engendered by the reform will be discussed in Chapter VII.

5.1 The Main Framework of the Proposed Reform

Québec households are found throughout the income scale. Some have no independent source of income, so that their essential needs are entirely financed by the State, while others not only provide for their essential needs but also pay a significant proportion of their income to finance public expenditures. Between these two poles lies an intermediate zone within which incomes, though not high enough to contribute to the financing of government expenditures, are adequate to cover at least a portion of essential needs. The main framework for the reform options will be presented with reference to these three zones of what is generally known as the fiscal curve, starting from the point at which employment income is nil and progressing to higher income levels. However, before going into the specifics of the various options, it would be useful to define the basic components of the proposed reform.

5.1.1 The basic components

The most significant modifications result from the need to integrate the tax system and the transfer programs. The accepted level of essential needs will therefore have to be reviewed (this applies equally to the transfer programs and the tax system), as well as all the factors which determine the zero transfer and taxation thresholds.

The implementation of a new approach to income redistribution makes it apparent that some of the transfer programs need to be merged. The result would be a program, called the income guarantee program, with a combination of new features applicable to the definition of essential needs and financial incentives encouraging beneficiaries to return to the labour market.

Another major change affects the tax rate table, which should be modified to reflect the following objectives: a competitive tax system, an increased incentive to work, an acceptable redistribution of income and the need to collect sufficient revenue.

Finally, to make the system more equitable, a number of changes are required, especially with respect to the system applicable to essential needs and child care expenses.

5.1.1.1 The transfer system

The analysis of the transfer system for low income individuals and households has demonstrated that the transfer programs are aimed at three separate target groups: students, people between 18 and 64 who are not in school, and persons 65 or over. For each of these groups, government assistance is furnished by a principal program and by supplementary programs. The principal program for students is the loans and scholarships system; for people between 18 and 64, it is social aid; for people 65 or over, the principal program is the federal old age security system which includes the old age security pension, the guaranteed income supplement and the spouse's allowance.

The orientations of the reform lead us to favour changing this basic framework and putting into effect a system for low-income people who are fit for work which would be separate from the system geared toward those who are unfit for work. Thus, the group between 18 and 64 who are not in school would be divided. The current program would continue to apply to those who are unfit for work. For the others, the new income guarantee program would become the principal assistance program.

The new transfer system for low-income persons would thus be based on four principal programs: student assistance, social aid, income guarantee and Old Age Security.

Currently, the array of supplementary programs is made up, in the first place, of programs intended to provide partial coverage of essential needs, such as family allowances, the availability allowance, the property tax refund and coverage of special needs. Then come programs which seek to encourage participation in the labour market: financial assistance for child care expenses, the employment income supplement, etc. All these supplementary programs would be integrated with the new income guarantee program for two reasons. First, nothing is gained by having several programs covering essential needs. Second, if the income guarantee program is to be effective in promoting a return to the labour market, the incentive to work function should not be spread among various programs.

Briefly, the structure of the new transfer system for low-income people would differ from the existing system by the creation of a fourth principal program, the income guarantee program, and by integrating into this program all current income support and work incentive functions for people between 18 and 64 who are fit for work and not in school. The program's operating conditions would take account of the amounts paid out by federal income maintenance and unemployment insurance programs, so that the Québec system would not cover essential needs to excess.

The new transfer system includes programs which supplement the four major programs and are all intended to fulfil a certain number of special needs. There are currently four of them for taxpayers under 65:

— special needs under social aid;

— legal aid;

— low-rental housing; and

— rent supplement for the handicapped and assistance to victims of UFFI.

The list of other current programs is much longer; however, family allowances, the availability allowance and the property tax refund were dealt with at the same time as the tax and transfer system, while programs respecting child care assistance and the employment income supplement have been incorporated into the new income guarantee program.

The first thing to be done with regard to each of these programs is to harmonize the criteria for eligiblity and the definition of essential needs they employ with those of other components of the tax and transfer systems. The same concepts of dependent, income and assets taken into account should be adopted. By using the same definition of essential needs, it will be possible to avoid doubly compensating some taxpayers.

The income guarantee program would maintain the special needs provisions of the current social aid system. However, given that the zero transfer threshold, as well as the number of beneficiaries, is increased under the various reform options relative to the current system, amendments would be introduced to hold the projected cost of special needs under the new income guarantee program to no more than the current level. These amendments, which would cost the government nothing, could entail, among other measures, restricting the definition of special needs to what is absolutely necessary to maintain the health of the beneficiary.

5.1.1.2 The tax system

Integration of the personal tax sytem with the new income guarantee program necessitates a common definition of recognized essential needs for people between 18 and 64 who are not in school and are fit for work. In addition, all the essential needs of these persons would be covered by the tax system or the income guarantee program. Thus, as long as the income of the individual or the household was insufficient, he would receive income guarantee payments which would be free from tax. However, when the taxpayer's income becomes sufficient to provide for his recognized essential needs and those of his dependents, he would be taxed on his income in excess of this threshold and would no longer receive transfers from the government. Then, his contribution to the financing of public expenditures would go up with his income.

Finally, the implementation of a sales tax credit would relieve the low-income taxpayer of the burden of the portion of those taxes applicable to recognized basic needs. The new property tax refund program would take particular account of the amount individuals must devote to paying such taxes relative to their income.

5.1.2 The transfer system for people able to work

For those between 18 and 64 who are fit for work and have no employment income, the new income guarantee program would ensure that their recognized essential needs were covered and that their minimum standard of living corresponded to the objectives of society. This new income maintenance program would combine the existing social aid program and the employment income supplement program. Benefits would be based on a beneficiary's recognized essential needs, his income and his assets.

This program would provide a minimum income to persons able to work; ordinary benefits would be paid to those who are available to participate in reintegration activities or who are prepared to search for employment. In addition, benefits would be paid to recipients who are not available to participate in reintegration activities or to look for a job. This latter benefit would be less than or equal to the ordinary benefit, depending upon the option. However, it is estimated that the overwhelming majority of beneficiaries under the new program would be available and would therefore be eligible for ordinary benefits.

In addition to providing persons fit for work with a minimum income, one of the objectives of the new program is to help them reenter the labour market. Two methods would be used. The first consists in reducing the implicit marginal tax rates on low-income workers to a more acceptable level. This rate is the result of combining the federal and Québec marginal income tax rates, transfer reduction rates, and the increase, if any, in child care expenses not covered by government assistance, in relation to the increase in employment income. The second consists of the many community service, on-the-job training and school catch-up programs which the government recently announced for social aid recipients under 30, to run for a trial period of 2 years. It would provide beneficiaries who are unable to reenter the labour market because they cannot find employment with the opportunity to increase their benefits by taking part in activities which improve their chances of finding work.

5.1.2.1 Ordinary benefits

Ordinary benefits apply to individuals or households with no other source of income but who are available to undertake a reintegration activity or to search for employment. Supplementary benefits may be paid for certain special needs (prescription drugs, prostheses, etc.). Since the goal is to ensure that everyone's socially accepted essential needs are covered, ordinary benefits are normally geared to expenditures to satisfy such needs, less the portion of those needs already covered by other transfer programs. Currently, federal and Québec family allowances, as well as the federal child tax credit, are deducted from amount of needs provided by Québec's transfer system.

The assessment of basic needs is therefore of paramount importance. In assessing them, we must avoid using arbitrary or subjective methods. A basis for evaluation which corresponds to economic reality can be found in the expenses actually incurred by low-income households to satisfy their essential needs. In addition, if the future income guarantee program is to provide a minimum incentive to work, then we must avoid a situation in which its beneficiaries enjoy a higher standard of living that low-income workers.

With the proposed approach for the identification and assessment of essential needs, for both the income guarantee program and the tax system, the standard level of essential needs is based on the level of expenses incurred by low-income households to cover these needs, that is, those whose income was under $13 700 in 1983 and was derived mainly from employment. Incomes under $13 700 correspond to those of heads of household, or spouses, working full-time, who fall into the first **income decile*** (10%). The expenses of these households can be ascertained from Statistics Canada's survey of family expenditures. However, a decision must be made as to which of the expenditures should be considered essential. Certain kinds of expenditures can be eliminated immediately, either because they are expenses related to employment, or because the expenses are judged not to relate to an essential need (expenditures on restaurant meals, alcohol, tobacco, etc.). Among the expenses considered, three classes can be distinguised:

1. Expenditures for short-term essential needs, that is, current expenses which entail at least monthly outlays. These would include food, housing, communications and expenses related to household work and personal care;
2. Expenditures for longer-term essential needs, that is, those which do not call for regular monthly outlays. These include clothing and furniture;
3. Expenditures for important but nonessential needs, such as public transportation, recreation and reading.

Table III.6 shows, for various household sizes, the average annual expenditures for such needs.

The level of recognized essential needs for a couple would be based on average expenses for two-person, low-income households. For persons living alone (single, widowed, separated, etc.) it would seem necessary to distinguish the way in which they occupy a dwelling.

For single persons sharing a separate dwelling, the level of essential needs recognized under the heading of dwelling would equal 50% of the level recognized as acceptable for a couple. But in order to protect the acquired rights of persons receiving social aid benefits at the time of the reform, benefits would continue to be paid on the basis of the recognized essential needs of a person living alone. However, when these single persons do not share their dwelling with other adults, a supplement would be added to cover the extra housing costs which low-income workers living alone must pay on average. In this case, the benefits would be set at about 60% of those for a couple.

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* Terms in boldface type are defined in the glossary.

As for the level of financial resources for dependent children under 21, the standard would be set in terms of the average extra expenses of the third person of a household — for the family's first child — and of the fourth person of a household — for the second and any other children. In this way, the recognized essential needs of the first child would be higher than those of the others.

In deciding upon the ordinary benefits for the income guarantee program, the sales tax paid on purchases for essential needs would be specifically refunded so that as long as the household received income guarantee benefits it would effectively not have to pay sales tax on its essential needs. Property taxes would be dealt with in the same way. The amount paid in property taxes would be included in the same way. The amount paid in property taxes would be included in the ordinary benefits, up to a level equal to the average amount of property taxes paid in Québec by low-income households (first decile). The property tax credit would provide a refund equal to 40% of property taxes in excess of this average, to income guarantee program recipients. Tenants who pay property taxes indirectly through their rent and property owners who pay it directly would be covered under this provision.

These are the general principles which were followed in assessing the level of essential needs for the income guarantee program. However, a choice must be made as to whether the level of ordinary benefits should be set exclusively in terms of **short-term essential needs** plus clothing (options II and III), or whether they should include **long-term essential needs** in their entirety (option I).

Under options II and III, ordinary benefits, that is, those for **persons who are available** to undertake a program of reintegration or to participate in activities offered to them, would be frozen at the present level when the reform is initially implemented, until they equal the level of expenditures by low-income households for short-term essential needs, plus clothing needs. When the reform is fully implemented, a decent income would be provided by the benefits paid to all beneficiaries who are available to follow a reintegration program, even if they have not actually been successful in finding an activity. The recognized needs under the income guarantee program would be the same as those currently recognized under the *Social Aid Act* (see section 3.2.4, page 128). Furthermore, there would be an incentive for recipients to find a job, since they would stand to gain.

5.1.2.2 Benefits for persons who are not available

A further choice must be made as to whether or not the level of benefits payable to those who, though able to work, are not available, should be the same as ordinary benefits (option I), or be based solely on essential short-term needs, that is, about 15% less than ordinary benefits (options II and III). A penalty system would therefore be applied under options II and III, which would reduce benefits for persons who are not available. By **persons who are not available** is meant those who are not prepared to participate in an activity to facilitate their reintegration into the labour market, or who are not interested in searching for employment, and those who either reject or leave a job they were able to perform or a reintegration activity that was offered to them. Obviously, as long as officials from the income guarantee program have not contacted a person, that person will not be considered as not available.

The decision rests on how much income society is prepared to guarantee to those who make no effort to search for employment, as well as on how great an increase in hourly wages it is prepared to give those who become more active in the labour market.

The Figures in Chapter VI (Figure VI.I and following) show for each of the three options and for different typical cases, what corresponds to ordinary benefits and the "non-availability" benefit and compare them with those under the existing system. For recipients 30 and over who are not available, option I presents a level of benefits that is usually equal to the present level, while options II and III present a lower level of benefits. Under the last two options, long-term needs would be guaranteed for those who are active, either in the labour market or by participating in a reintegration activity.

5.1.2.3 Benefits for persons under 30 without children

Under the existing system, benefits paid to persons under 30 who are fit for work and have no children are clearly lower than those for persons under 30 who are unfit for work, or who have children, or who are over 30 years of age. As a result, childless beneficiaries under 30 are themselves responsible for covering a greater proportion of their essential needs. The reform aims to assist this group by introducing significant improvements in the program of activities for reintegration in the labour market.

As for persons aged from 21 to 29 who have no children and are fit for work, whether or not they are available, all three options retain the level of benefits currently in effect. Such an approach assumes that beneficiaries in this category are responsible for meeting a portion of their basic needs. The government would extend the field of remunerative activities to allow a beneficiary to meet his essential needs more completely, not only by enabling him to increase his skills in order to find work, but also by allowing him to draw a higher level of benefits.

Nonetheless, it should be noted that persons under 21 may receive social aid benefits even if their parents have sufficient financial resources. Currently, a young person from a well-to-do family, who is the same age as a CEGEP student or university undergraduate, receives government assistance if he is neither working nor in school. Should he return to school, he would lose this assistance and would have to look to his parents for financial support. The current system therefore does not encourage pursuing studies. For this reason, the transfer system for persons aged 18 to 20 is considered further on, along with the present system of financial aid for students.

5.1.2.4 Benefits for recipients who are temporarily unable to work

It sometimes happens that social aid beneficiaries are temporarily unable to work or participate in a reintegration activity, whether for reasons stemming from their family situation or because of what is considered a temporary mental or physical disability. They are then said to be temporarily unable to work. *Persons who are judged by a medical committee to be unable to work in the short term because of their state of mental or physical health shall be considered unable to work for health reasons.* Under the proposed system, these people would be eligible for benefits under the income guarantee program. However, for the period during which they are considered temporarily unable to work, they would receive benefits equivalent to those of a household in which one person participates in community activities for 20 hours a week. For example, under option II, a person between 30 and 64 living alone in a separate dwelling would receive various transfers totalling $5 305, $3 779 in non-availability benefits and additional net remuneration of $1 500 for presumed participation in community activity. A further $26 from the property tax credit is also included, on the assumption that the person paid the average amount of taxes paid by persons with the same disposable income.

It should be noted that under the income guarantee program, a couple would be declared temporarily unable to work only when both adults are in that situation. If either of the adults is able to work, the household would not be eligible for the special benefits described above, unless the spouse who is not able to work requires constant attendance. However, there are certain cases in which the criteria for declaring a person temporarily unfit for work would be extended. Such would be the case, for example, for single-parent families with a child under 2 years or with more than two children under 12 years, or with a child who is ill and requires constant attendance. Such would also be the case for chronic alcoholics and drug addicts who are considered unable to work, for families which are responsible for an unfit person requiring the constant presence of an adult.

These activities focus on occupational and professional training, academic development, industrial training and community work.

5.1.2.5 Marginal transfer reduction rates

Under each of the options, the non-availability benefits under the new income guarantee program constitute the minimum level of income received by beneficiaries who are not available. Under options II and III, when the reform is implemented, beneficiaries who are available will receive benefits which are 15% higher than those for persons who are not available. These supplementary benefits may be viewed as remuneration paid to persons who are available to search for a job or a reintegration activity. When a beneficiary earns employment income, he may continue to receive benefits under the income guarantee program if his income from employment does not exceed the zero transfer cutoff point. This benefit is based on the non-availability benefit (the benefit to which he would be entitled if he refused or left a job he could perform), and would be reduced by the marginal transfer reduction rate applied to employment income. To summarize, the new income guarantee program for persons who are able to work would allow beneficiaries entering the labour market at a low income to retain a greater proportion of their earnings from employment than under the existing transfer system.

The proportion of employment earnings left in the hands of income guarantee program beneficiaries depends on the marginal benefit reduction rate, which is different under each option. When the non-availability benefits are higher (option I), the government must compensate by reducing these benefits at a faster rate when employment income increases, since its financial leeway is fixed. A beneficiary's net increase in hourly wages as a result of returning to work or participating in reintegration activities will therefore be less attractive.

However, when the non-availability benefits are reduced to the level of short-term essential needs (options II and III), the marginal benefit reduction rates are lower and the return to work, or participation in reintegration activities, becomes more attractive financially. These rates, shown in Table V.1, are generally 67% for option I and 50% for options II and option III.

The same compensation level would apply in each of the proposed options for a given activity. However, this compensation would be treated exactly like employment income, that is, it would be subject to the same marginal transfer reduction rates. It would not be taxed for those under 30 without children until their disposable income reached the same level as that of other beneficiaries. While the gross hourly remuneration for beneficiaries under 30 may appear low, the net result would be comparable to that observed for other beneficiaries.

For example, under option II, a family with two children under 12 which devoted 30 hours per week to a community activity would increase its disposable income for the year by $2 250 compared with its situation if it were not available. If that family worked 40 hours a week at the minimum wage, it would increase its disposable income by $4 121, and if it participated in an industrial training program for 40 hours a week, its disposable income would show a $3 246 increase. Under the existing system, this family would increase its disposable income by only $1 669 or $1 699 for 40 hours a week at the minimum wage depending on wether the children were between 6 and 11, or under 6. The net gain this family would receive for part-time participation in community or training activities, according to option II, would be greater than the net income it now earns from full-time employment at the minimum wage.

The result would be similar under option III. In addition, combining the compensation structure for reintegration activities as recommended in the reform with the marginal transfer reduction rates on low incomes, it would always be financially more advantageous to be working, especially under options II and III. Thus, the fiscal structure which underlies options II and III ensures that the monetary gain from reintegration activities is higher

Table V.1

Marginal transfer reduction rates by reform option for income guarantee program beneficiaries

	Reform option		
	I	**II**	**III**
Benefit reduction rate applied to income net of employment-related expenses[1]	67%	50%	50%
Income threshold net of employment-related expenses[1] for persons under 30 without children below which benefits are not reduced:			
• Single persons charing a separate dwelling	2 831 $	2 102 $	2 102 $
• Single person living alone	3 852 $	3 470 $	3 470 $
• Couple	5 662 $	4 204 $	4 204 $

[1] These expenses include unemployment insurance (6%, with a maximum of $750) and QPP contributions as well as the standard employment expense deduction.

than that now earned from employment at the minimum wage, so that even at low wages it is always advantageous for the beneficiary to accept a job rather than remaining dependent on government assistance.

For single persons and childless couples under 30 who would receive lower benefits than other recipients, income guarantee benefits would not go down until disposable income reached the level of recipients 30 or over (see Table V.1). In this way, all categories of income guarantee program recipients would leave the program at the same rate. In other words, the marginal benefit reduction tax rates for those under 30 without children are nil until they reach the disposable income level of those 30 or over for the same activity, and above this threshold the rates apply in the same way as for those 30 or over. As a result, persons under 30 have a strong incentive to work. Indeed, the increase in disposable income for recipients under 30 without children, following their entry into the labour market, will continue to be higher than for persons 30 or over, but beginning with the threshold of earned income, net of employment-related expenses (unemployment insurance and QPP contributions, as well as the standard employment expense deduction), indicated in Table V.1, their disposable income will be the same, which is not the case under the present system.

5.1.2.6 Reintegration activities

The existing methods, under the transfer programs, of encouraging social aid recipients to return to the labour market are deficient in many respects. First, a low-paying job will often result in a ridiculously small increase in net disposable income. Next, these programs offer activities for reintegration in the labour market only to a small number of recipients.

The proposed income guarantee program would provide additional compensation to people able to work who take part in community activities, occupational or academic training or industrial training. The government's contribution to this compensation would be proportional to the number of hours of activity and would be calculated based on the non-availability benefit. However, this would be limited to 20 hours per week except in the case of participation by one partner of a couple with children, when the maximum would be 30 hours.

Table V.2

Additional annual remuneration for participation in reintegration activities
(in dollars for 20-hour week of community or training activities)

	Community activity		**Academic or occupational training**		**Industrial training**			
					Government	**Industry**	**Total**	
	Gross	**Net[1]**	**Gross**	**Net[1]**	**Gross**	**Gross**	**Gross**	**Net[1]**
Present plan under recovery program[2]								
Persons under 30 without children	1 800	1 800	1 800	1 800	1 800	1 200	3 000	3 000
Proposed plan:								
Persons without children								
21-24 years	1 000	1 000	1 500	1 500	1 500	1 000	2 500	2 500
25-29 years	1 500	1 500	2 000	2 000	2 000	1 000	3 000	3 000
30-64 years	3 000	1 500	3 000	1 500	3 000	1 000	4 000	2 000
Persons with children								
Two-parent[3]	4 500	2 250	4 500	2 250	4 500	1 500	6 000	3 000
Single-parent	4 000	2 000	4 000	2 000	3 000	1 000	4 000	2 000

[1] For illustration purposes, net remuneration is based on options II and III for which the implicit marginal tax rate is 50%.

[2] Also intended for persons under 30 with children who are eligible for the refund of child care expenses for single-parent families, instead of this government assistance or, in the case of a couple, refund of various expenses incurred by participating in these programs, up to $100 per month.

[3] Two-parent families with children will receive additional benefits for reintegration activities up to 30 hours per week.

These compensation rates would be chosen in such a way that a recipient taking part would be paid less than what a worker in the private sector earns (Table V.2). Applied to the number of subsidized hours, these rates would allow each person, by engaging in a reintegration activity, to reach an income enabling him to satisfy his short and long-term essential needs, in each option. Finally, in order to encourage young people to put training programs high on their list of priorities, the additional compensation applicable to this type of activity would, in their case, be higher than those for community activities. Industrial training, which calls for a contribution from the firm, offers the highest salary scale because it provides the greatest possibilities for "employability" enhancement.

5.1.2.7 Expenses related to employment, studies or reintegration activities

Working, studying or taking part in reintegration activities necessarily entails expenses which may vary according to the recipient's situation. The main expenses are related to the care of young children.

— Additional assistance for child care expenses

In order to increase the net gain from participating in the labour market of families with young children, the new income guarantee program would provide for an additional benefit for child care expenses, which would be available to all program recipients who are actively employed, studying, or involved in community work or industrial training.

It would be equivalent to half the allowable child care expenses under options II and III and 67% under option I. The rates of compensation for child care expenses would be set with a view to avoiding having the reduction benefit rates and the marginal income tax rates accumulate to the extent that they strongly discourage individuals with certain incomes from working, as is the case under the current system.

A study of essential child care needs indicates that the basic cost in day care centres may total $3 120 per year (in 1983) for children under six. Children at the elementary school level (aged 6 to 11) require 50% of the care required by children under six during the normal hours of full-time employment. Thus, the maximum child care expenses allowable for the additional benefit would be $3 120 per child under six, and $1 560 for each child between 6 and 11; since 50% of expenses are allowable under options II and III, the additional benefit could reach $1 560 and $780 respectively for these children. To be allowable such expenses would have to be incurred by recipients who were in fact working, studying or participating in reintegration activities. In the case of couples with children, the two spouses would have to be working or participating in reintegration activities to benefit.

There are, moreover, relatively few beneficiaries under the current program of assistance for child care expenses, as it only applies to children placed in day care centres recognized by the Office des services de garde à l'enfance. There are barely 15 000 children eligible for the grant, which should be made available to all families benefiting from the income guarantee program who incur child care expenses, whether with a family or institution. This would make the program fairer. It would nonetheless be up to the Office des services de garde à l'enfance to exercise the powers conferred on it by law — supervision of child care agencies for example.

On the other hand, a special tax status could be established for those who care for children and incur expenses related to such care, in order to increase the number of places available in day care centres, as a means of fulfiling needs in the most appropriate, economical fashion possible. Such persons could claim, for tax purposes, an amount of expenses proportional to the income earned, without supporting documents. Such a measure, by simplifying the administrative task of those who care for children, might help increase the number of places available in day care centres. In addition, consideration should be given to expanding the status of guardian to persons under 21 who are related to either spouse by ties of blood, marriage (except for the spouse) or adoption.

These elements of the policy on child care costs are dealt with in this *White Paper* because of their fiscal implications, for they are work-related expenses. This does not mean that other objectives or policy elements not related to the tax system are to be excluded from the question of child care costs, or that no other programs will be considered.

— Other work-related expenses

The income guarantee program would include the same system for deducting other work-related expenses as the tax system. Employees' contributions to the Québec Pension Plan and Unemployment Insurance would be deducted from earned income for the purpose of calculating benefits. The general deduction from earned income under the tax system would also apply in calculating benefits.

5.1.3 The tax system

The proposed income guarantee program is aimed at ensuring sufficient income for those who are able to work, while encouraging them to do so. Integration of this program into the tax system would mean that recognized essential needs in both instances were established on the same basis, and that recognized work-related expenses were the same. On the other hand, to avoid having an individual pay income tax while receiving income guarantee benefits the tax system must begin to apply at a level above that of essential needs. For example, to reach an implicit marginal tax rate of 50%, which is equal to the marginal transfer reduction rate under option II, the tax threshold would have to be set at twice the level of recognized basic needs. Thus, if a family's recognized basic needs amount to $8 000, it would receive income guarantee program benefits under option II until its income reached $16 000, and would begin to pay tax only at that point. To increase the incentive to work, it is necessary to reduce implicit marginal rates, and in order to do so, benefits under the income guarantee program should not be reduced at the same time as taxes payable are increasing.

Incentives to produce and reside in Québec must be enhanced. The burden of personal income tax must be reduced in order to make the tax system more competitive.

5.1.3.1 Taxable income

We saw in Chapter IV that a number of sources of income are not included in the income **tax base**, while others are only partially included, thus making the tax system less equitable than it might be. It was also noted that several categories of tax expenditures granted as deductions from income, especially against business income and income from property, raise the same questions with regard to fairness.

As for the definition of **income subject to tax** and deductions from income which are not explicitly related to the taxpayer's **ability to pay**, Québec can hardly act independently of the other provinces and the federal government. It must not create a taxation system which is too different from that of Canada, to avoid confusing the taxpayers. Up until now, Québec has only rarely deviated from this policy. Nonetheless, these problems will have to be resolved one day, either at the instigation of the federal government, or through federal-provincial discussions, or by any other appropriate policy. As for the definition of income subject to tax and the deduction of income not explicitly related to a taxpayer's ability to pay, it would be difficult for Québec to act independently of the other provinces on these measures.

In the interim, it is possible for Québec to change the definition of income which reduces the amount of exemptions for dependents. Personal exemptions are not the object of harmonization with federal legislation, as Québec has decided to pursue its own policies. In future, income which reduces various exemptions for dependents will include all transfers received from one level of government or the other, thus making the personal income tax system more equitable while making it easier to integrate the tax and transfer systems.

Furthermore, Québec could require each of its high-income taxpayers to make a minimum contribution to the financing of government expenditures, by paying a minimum of income tax, equal to a certain percentage of ability to pay, or by placing a limit on the utilization of deductions. This question will be dealt with more fully in chapter VII.

5.1.3.2 Personal exemptions

As personal exemptions play a major role in the progressivity of the tax system and the process of the redistribution of income, merely outlining a new approach to distributing income can only lead to extensive revisions in personal exemptions, all the more so as better integration of the tax and transfer systems is also sought.

The purpose of personal exemptions is, of course, to ensure that income tax is not paid on the part of a taxpayer's income which is necessary to cover his, or his dependents', essential needs. Thus, personal exemptions must be brought into line with what are deemed to be the essential needs of the person claiming the personal exemption. Under a unified tax and transfer system, the same notion of essential needs must be employed.

The new approach selected with respect to the transfer system consists of adopting as a standard for essential needs the expenses actually incurred by low-income households to satisfy those needs. This approach must also be applied to the tax system. Accordingly, under the tax system, essential short and long-term needs and important but nonessential needs would be recognized under all the options presented.

On the basis of such expenses, the total exemption for a couple would be $8 784 under the 1983 tax structure (Table V.3). This exemption would include a maximum of $430 under the heading of property taxes, and taxes in excess of this figure would be entitled to a property tax credit of 40%. The question of property taxes will be examined in greater detail later.

For a couple, this personal exemption is divided equally between the two spouses, that is, $4 392 each, including a maximum exemption of $215 with respect to property taxes. The new system would be markedly different from the old one, as it makes no distinction between the basic exemption and the spouse's exemption. However, an individual living alone (without another adult) in a separate dwelling could claim a special basic exemption of $684 representing the additional cost of his way of life in terms of essential needs.

This new system of exemptions would have the advantage of being much fairer, and would deal in a neutral way with households made up of single persons and those made up of couples, and households comprising couples with one or two breadwinners. Moreover, it also only recognizes additional expenses incurred where an individual lives alone, when they have actually been incurred.

Out of the same concern for dealing fairly with various types of households, and in order to harmonize the tax and transfer system, the spouse's exemption should also be granted to de facto spouses. Integrating both systems on the administrative level would minimize the possibility of tax evasion brought about by this extension of the exemption to all those officially recognized as de facto spouses. Moreover, an exemption of $4 177 would be granted for all dependents who are 21 or over, including children.

For dependent children, as we have seen, family allowances could be replaced by a system which took greater account of the household's ability to pay. Exemptions for children under 21 would be equal to expenses for the essential short and long-term needs as well as important but nonessentiel needs determined for the third and fourth members of low-income families. For example, under options I and II, the exemption for dependent children, including the maximum property tax deduction of $55, is higher for the first child ($1 668) than for the others ($1 224), in recognition of the fact that second and subsequent children cost less because of economies of scale. Such exemptions would be the same, regardless of the age of children under 21, or the type of family, and would replace Québec family allowances for those who pay taxes. However, as the essential needs of children would be partly compensated for by federal family allowances, Québec exemptions would be reduced by making federal family allowances taxable, as is the case in all the other provinces.

Despite its merits, a system based on personal exemptions rather than family allowances is a considerable change of direction, and would in fact eliminate a payment made directly to the mother. Under the circumstances it is important to consider the two systems and carry the debate to the public forum. To this end, the various consequences of the alternatives, as well as a possible compromise, will be examined in Chapter VII.

The exemption for the equivalent of a married person would be eliminated under the proposed system. An exemption for another dependent person of 21 or more (in the amount of $4 177) would replace it for this group. With respect to children under 21 who belong to single-parent families, society should be heard, and this question will be discussed in Chapter VII.

The age exemption will be dealt with later. The principle of the disability exemption is maintained, as it pursues particular objectives. However, further consideration should be given to a special deduction for possible additional needs of some handicapped persons, either for their essential needs or the cost of their holding a job. The policy to be pursued for the handicapped in the tax system, throughout the income scale, would be to avoid taxing income used to defray their additional costs. The terms of its implementation will be drawn up as a supplement to the policy governing handicapped persons.

One last measure to be reviewed is the automatic $100 deduction, which the federal government eliminated recently, to avoid having it discourage modest contributions to charitable organizations. There is every reason to follow Ottawa's lead in this matter.

Personal exemptions must be reviewed with respect to the levels of income which do not reduce exemptions for dependents. These various levels of income have, historically, been created out of a concern for administrative simplicity. This policy creates problems related to fairness in the taxation of income, and encourages **tax evasion**. These problems could be solved were such limits abolished. Doing so is also necessary to achieve better integration of the tax and transfer systems where, for example, a dependent receives transfer income. Thus, the first dollar earned by a spouse or other dependent would be applied against the corresponding exemption. This would have the advantage of reducing the incentive split income between the spouses in order to reduce income tax.

5.1.3.3 Expenses related to entering the labour market

Employment-related expenses are of two kinds: general expenses and those connected with the presence of children.

Not taking full account of employment-related expenses raises problems of fairness between the various categories of taxpayers. It may also act as a disincentive to work. Moreover, as the main expenses related to employment are incurred by households for which child care is an important consideration in deciding whether or not to enter or re-enter the labour market, that is, heads of single-parent families and couples where both spouses work, it is obvious that this question merits considerable attention.

— The deduction for general employment expenses

Occupying a job generates for the worker a number of costs he would not have incurred had he remained outside the labour market. General employment-related expenses are the costs of travelling to and from work, meals eaten outside the home, additional clothing costs, and costs for special equipment and tools. Given these expenses, the present exemption seems rather low, particularly for low-income workers, for whom the return to work can be especially onerous. To increase the incentive to work, as a first step the general deduction for work-related expenses would be increased from 3% to 6% of income earned up to $750, compared to the present maximum of $500. A study on this question will allow us to determine whether or not to pursue the matter.

— The child care expense deduction

The current child care expense deduction is insufficient in certain instances, but needlessly generous with respect to children between 6 and 13. The basic principle under the tax system is that child care expenses are indeed an expense incurred to earn income; consequently, they must be entirely deductible.

Thus, there is every reason to raise the ceiling on the child care expense deduction. A study of needs in this area indicates that, for 1983, this ceiling should be set at $3 120. Second, it is necessary to grant the deduction to either spouse, rather than the one with the lower income, since the income earned by the second spouse is taxed at the marginal rate of the first having reduced the exemption which the first spouse may claim with respect to the second. This policy has the advantage of facilitating the second spouse's entry into the job market.

However, it is important that the deduction for child care expenses only be granted to facilitate entry into the job market, or to further one's education. It is necessary to introduce a certain number of provisions, to ensure that this deduction is not claimed by a taxpayer whose spouse is not working outside the home. The maximum deduction is equivalent to 40% of the income of the spouse with the lower income. Thus, the maximum deduction of $3 120 per child may be claimed by someone with an annual income of about $8 000, derived from working full-time at the minimum wage.

However, the 40% of income maximum would evidently not apply when one of the spouses is studying full-time, or when both spouses are studying part-time. Moreover, a second, lower ceiling applies for children six or over, since child care expenses for them are lower. It is equivalent to 50% of the normal ceiling for the deduction, that is, $1 560 in 1983. It should be noted that the child care expense deduction is not granted for children 12 or over. It is limited to the total of eligible amounts for a family with three children, in recognition of the fact that economies of scale may intervene in families with more children.

Where expenses related to entering the job market, arising from child care, and essential needs related to the usual care of children are clearly taken into account, the availability allowance is no longer justified, except for children under two. For the parents of these young children, the question of incentive to work taxes on a different aspect and

Table V.3

Exemptions and deductions related to essential needs, by option
(in dollars)

	Current System	Options I and II	Option III
Adults			
• Adults living alone in separate dwelling			
— Exemption and deduction	5 130	4 392	4 482[1]
— Special exemption relative to the cost of housing	—	684	684
— Total	5 130	5 076	5 166
• Single adult living with other adults			
— Exemption and deduction	5 130	4 392	4 482[1]
• Spouse			
— Exemption and deduction	3 770	4 392	4 482[1]
• Couple			
— Exemption and deduction	5 130	4 392	4 482[1]
— Spouse's exemption and deduction	3 770	4 392	4 482[1]
— Total	8 900	8 784	8 964
• Other dependents aged 21 or over	1 260[2]	4 177	4 267[1]
Children under 21			
• First child			
— Basic exemption	[3]	1 668	1 698[1]
• Second and subsequent children			
— Basic exemption	[3]	1 224	1 254[1]

1. This higher exemption under option III is designed to reflect the impact of the increase in consumption taxes on the essential needs presented under this option.
2. A single separated, divorced or widowed taxpayer may be entitled, under the current system, to an exemption equivalent to that of a married person for another dependent (see Chapter II, section 2.2.1.3).
3. Essential needs covered by the current tax system, with family and Québec availability allowances converted into an exemption at the maximum marginal rate, are:

	First Child	**Second Child**
Under 6	1 219	1 002
Between 6 and 11	282	377
Between 12 and 15	282	377
Between 16 and 17	1 052	1 147
Between 18 and 20	1 260	1 260
21 or over, studying or disabled	1 260	1 260

Note: Under each option, the exemptions include the maximum deduction for property taxes: $215 per adult and $55 per dependent child, with the exception of other dependents 21 or over.

many of them decide to bring up their children rather than return to work. The increased deduction for child care expenses for children from 2 to 5 compensates for the withdrawal of the availability allowance in the case of the working spouse. In the case of the spouse remaining at home, the improved system of compensation for family responsibilities plays this role.

The new system introduces greater equity as between the treatment of the child care needs of preschool children, and other child care needs. The advantage is that such a policy offers a greater incentive for spouses in the home with children under six to work outside it, without penalizing them financially.

— Other expenses

The third category of expenses which arise when wage earners enter the job market also relates to children. In this instance, the expenses are those other than child care expenses, such as housekeeping or other domestic services which wage earners no longer have time to carry out, since they work outside the home. The manner in which such expenses may adequately be taken into account is still being considered; concrete proposals will be submitted at the conclusion of the study.

5.1.3.4 Income tax

Once **taxable income** has been defined, the income tax table determines the amount of tax which must be paid on such income. In this realm, the changes to be made may be extremely costly. The objectives pursued are, first, to make Québec's tax system more competitive and, second, to reduce the implicit marginal tax rates. Such a policy precludes the possibility of increasing tax revenues in any way.

Budgetary constraints are decisive if such objectives are to be pursued. It is for this reason that it is necessary to envisage two possibilities, each being determined by the extent to which income tax is to be reduced. The first solution would reduce income tax (options I and II) on the basis of a $600 million cushion; the second approach (option III) is based on broadening the sales tax base which would generate an additional $900 million, to be used to further reduce the marginal tax rates of all taxpayers.

— The tax table

It is clear that irrespective of the option considered (Table V.4), a smaller number of **taxable income brackets** is envisaged. Marginal rates may seem higher at the beginning of the curves proposed than in the present structure. However, the greater spread within the lower taxable income brackets does not lead to such a rapid increase in marginal rates. In any event, the new tax tables would have the effect of reducing marginal rates for every level of taxable income under option III. Under the other options, the marginal rates are lowered for taxable income above $12 000 (option I), or $17 400 (option II). Moreover, when account is taken of the lump-sum tax reduction intended to reduce the average tax rates of low-income earners, which will be dealt with later, the effect of increasing income tax in the first income tax brackets is partially offset.

The maximum marginal rate is reached on taxable income varying between $69 800 and $71 800, according to the option, and would be 30% under options I and II, and 28% under option III. By adding the maximum marginal rate of federal income tax (28.4%), the Québec taxpayer would be facing an overall maximum marginal rate of 58.4% under options I and II and 56.4% under option III, compared with 60.4% at present. These maximum marginal rates remain higher than those in Ontario (51%), although the lump-sum tax reduction throughout the income scale and maintaining the Stock Savings Plan reduce the discrepancies considerably.

However, to adequately compare these different tax tables, account must be taken of personal exemptions and the level of various tax credits. The following chapter deals with the overall effect of this change.

— The lump-sum reduction in income tax

The lump-sum reduction in income tax under the proposed system is necessary to shift the zero taxation floor to a higher level of income, thereby ensuring that the tax system only comes into play once the zero transfer cut-off point of the income guarantee program has been reached. This reduction is higher for households in which the essential needs recognized by the transfer system are higher, as the amounts of transfers to be reached are more substantial (Table V.5). this question will be dealt with in greater detail in the last chapter.

Table V.4

Québec income tax tables
(applicable in 1983)

Current situation		**Option I**		**Option II**	
Taxable income bracket ($)	**Marginal rates[1] (%)**	**Taxable income bracket ($)**	**Marginal rates (%)**	**Taxable income bracket ($)**	**Marginal rates (%)**
0 — 577	13	0 — 1 575	16	0 — 2 300	16
577 — 1 244	14	1 575 — 2 700	17	2 300 — 3 050	17
1 244 — 2 015	15	2 700 — 4 086	18	3 050 — 4 018	18
2 015 — 2 906	16	4 086 — 5 794	19	4 018 — 5 266	19
2 906 — 3 936	17	5 794 — 7 897	20	5 266 — 6 876	20
3 936 — 5 127	18	7 897 — 10 489	21	6 876 — 8 952	21
5 127 — 6 504	19	10 489 — 13 682	22	8 952 — 11 632	22
6 504 — 8 095	20	13 682 — 17 616	23	11 632 — 15 088	23
8 095 — 9 935	21	17 616 — 22 462	24	15 088 — 19 546	24
9 935 — 12 061	22	22 462 — 28 433	25	19 546 — 25 298	25
12 061 — 14 519	23	28 433 — 35 789	26	25 298 — 32 717	26
14 519 — 17 360	24	35 789 — 44 852	27	32 717 — 42 288	27
17 360 — 20 644	25	44 852 — 56 017	28	42 288 — 54 635	28
20 644 — 24 441	26	56 017 — 69 773	29	54 635 — 70 562	29
24 441 — 28 829	27	69 773 and over	30	70 562 and over	30
28 829 — 33 902	28				
33 902 — 39 766	29				
39 766 — 46 544	30				
46 544 — 54 380	31				
54 380 — 60 714	32				
60 714 and over	33				

Option III	
0 — 2 200	13
2 200 — 3 000	14
3 000 — 4 000	15
4 000 — 5 250	16
5 250 — 6 813	17
6 813 — 8 766	18
8 766 — 11 207	19
11 207 — 14 259	20
14 259 — 18 073	21
18 073 — 22 842	22
22 842 — 28 802	23
28 802 — 36 253	24
36 253 — 45 566	25
45 566 — 57 208	26
57 208 — 71 760	27
71 760 and over	28

[1] Not taking into account the 3% universally applicable reduction of tax payable.

5.1.3.5 Consumption taxes

— The sales tax credit

To ensure that no consumption tax is imposed on a low-income family's basic necessities, a sales tax credit is being proposed. Already, under the current system, certain basic necessities are taxed. It is estimated that a low-income family with two children pays $160 a year in sales taxes when purchasing such goods. Thus, a sales tax credit is being proposed, which would be applied throughout the low-income scale and would vary according to the size of the family, as set out in Table V.6. However, it is reduced to the rate of 3% of income above the zero tax threshold, so that it would be paid only to low-income taxpayers.

— The sales tax base

The *White Paper* proposes two solutions with respect to consumption taxes. Options I and II provide for no alteration in such taxes. Option III collects an additional $900 million by broadening the sales tax base to include all goods except food, prescription drugs and professional services. This amount could help finance a further reduction of all marginal income tax rates, thus making Québec's tax system more competitive in relation to Ontario's. It also offers a greater inducement to work.

The broadening of the sales tax base would also generate some $125 million in such taxes from business. However, the increase in such tax revenues would not be applied to the reform of the personal income tax system, but rather towards a reduction in other taxes levied from business. The overall tax burden borne by business would not, therefore, be changed by broadening the sales tax base.

5.1.3.6 Property taxes

It has been shown that property taxes are regressive in nature and that the current **property tax refund** is inadequate in certain respects. It reimburses social aid recipients for among other things, a tax already compensated for in the present scale covering housing costs, thereby leading to double compensation for this expense.

Variations in property taxes from one municipality to another are well known; the amounts paid depend on the extent of services provided. For this reason, the property tax refund is tied to property taxes actually paid by the taxpayers, or the taxpayer's share of such taxes in the case of tenants.

The property tax refund must be maintained, but with certain modifications in how it is applied. It is to be noted, however, that should a general housing allowance system be implemented, as proposed in the recent Green Paper on housing, the transfer system would take housing costs as a whole into consideration, in which case the property tax refund would be integrated to the housing allowance system.

Table V.5

Proposed lump-sum reductions in income tax
Québec
1983 taxation year
(in dollars)

	Basic income tax reduction		
	Single person sharing a separate dwelling	**Person living alone**	**Couple**
Option I	220	275	440
Option II	265	375	530
Option III	205	290	410

Table V.6

Sales tax credit for low-income earners
(in dollars)

	Basic credit	**Credit for spouse**	**Credit for a child**	**Credits for a family with two children**
Options I and II	60	60	20	160
Option III	150	150	50	400

Table V.7

Comparison of zero tax thresholds[1] under the current system and under various options
1983 taxation year
(in dollars)

	Current situation	**Option I**	**Option II**	**Option III**
Single person living with others				
— Exemptions and deductions	5 130	4 767	4 767	5 636
— Employment-related expenses	357	654	686	774
— Lump-sum tax reduction	—	1 375	1 656	1 577
— Zero taxation floor	5 487	6 796	7 109	7 987
Single person living alone in separate dwelling				
— Exemptions and deductions	5 130	5 451	5 451	6 319
— Employment-related expenses	357	769	840	925
— Lump-sum tax reduction	—	1 719	2 344	2 231
— Zero taxation floor	5 487	7 939	8 635	9 475
Childless couple, one spouse working outside the home				
— Exemptions and deductions	8 900	9 534	9 534	11 272
— Employment-related expenses	645	1 274	1 297	1 365
— Lump-sum tax reduction	—	2 750	3 313	3 154
— Zero taxation floor	9 545	13 558	14 144	15 791
Two parent family with two children under 6[2], one spouse working outside the home				
— Exemptions and deductions	15 069	13 867	13 867	16 617
— Employment-related expenses	1 076	1 459	1 480	1 511
— Lump-sum tax reduction	—	2 750	3 313	3 154
— Zero taxation floor	16 145	18 076	18 660	21 282
Two-parent family with two children between 6 and 11, one spouse working outside the home				
— Exemptions and deductions	11 104	11 992	11 992	14 309
— Employment-related expenses	814	1 263	1 283	1 485
— Lump-sum tax reduction	—	2 750	3 313	3 154
— Zero taxation floor	11 918	16 005	16 588	18 948
Two-parent family with two children between 6 and 11, both spouses working outside the home				
— Exemptions and deductions	12 464	11 992	11 992	14 308
— Employment-related expenses	2 857	5 023	5 068	5 214
— Lump-sum tax reduction	—	2 750	3 312	3 154
— Zero taxation floor	15 321	19 765	20 372	22 676

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1. The zero tax threshold is made up of personal exemptions, deductions for employment-related expenses (general deduction, child care deduction, unemployment insurance and QPP contributions) and income which nullifies the effect of the basic sales tax credit and the effect of the lump-sum tax reduction. The sales tax credit and lump sum tax reduction are converted into exemptions at the minimum marginal rate.

2. One of the children in this family is under 2 years of age, the other between 2 and 5. For families with two children under 2, the threshold is higher than 1 287 $, 1 280 $ and 1 538 $ respectively under options I, II and III because of the availability allowance.

If such a system is not implemented, however, the property tax refund should take a different form. To begin with, to ensure that the tax system does not continue to provide double compensation for property taxes, the portion of these taxes paid which corresponds to essential needs would be integrated with the income guarantee benefits and personal exemptions. For 1983, this would amount to $215 per adult and $55 per child. Property taxes in excess of these basic amounts would be handled by a credit similar to the current property tax refund: a refundable property tax credit of 40% of the paid or imputed property taxes in excess of the amount which is compensated for under personal exemptions or the income guarantee program, less 2% of income in excess of the zero taxation floor. The excess property taxes eligible for the credit would be limited to $800 (in 1983).

The property tax credit would fulfil both objectives ascribed to it, that is, it would compensate for the regressive nature of property taxes by refunding the major portion of them to low-income wage earners, and would not tax income allocated for basic necessities.

5.1.4 Summary of the reform

The questions which have just been discussed make up the general framework within which are elaborated the tax system, on the one hand, and the transfer system for those able to work, but who have insufficient financial resources, on the other. Other facets of the reform, which may be added later (presented in section 5.2), must be incorporated bearing in mind the fundamental notion of minimum income corresponding to essential needs, recognized across the taxation curve, that is, the curve of transfer reduction rates and income tax rates. Each option attempts to adopt such an approach while pursuing the objectives outlined earlier. Choices made with respect to the various objectives differ from one option to another.

Since the proposed reform rests on the principle that the taxation system and the transfer system should never apply simultaneously to the same person, a good way to illustrate it is to consider the zero tax thresholds it produces. Table V.7 indicates the zero tax cutoff point beyond which individuals pay taxes and below which they receive benefits under the income guarantee program. Such points vary according to each option; they are determined by combining the non-availability benefits selected and marginal transfer reduction rates. It should be noted that these thresholds are considerably higher, especially with respect to families with children.

5.2 Special Features of the Reform

The preceding section outlined the general framework of the reform of the tax system as it applies to individuals. This section presents those aspects of the reform which concern assistance for young people 18 to 20, transfers to those aged 65 or more, and housing assistance programs. To conclude, the reforms necessary to integrate the tax and transfer systems will be studied.

5.2.1 Young people 18 to 20

Current policies respecting school-age young people — especially those who are considered to be dependents for the purposes of the student assistance program — hardly encourage them to study. For example, an 18-year-old CEGEP student living at home, whose father earns the average industrial wage, will receive a loan of $1 075 each year under the student assistance program. Were he to abandon his studies, he would receive $1 758 a year under the social aid program. The loan in the first instance must be reimbursed, while benefits received in the second need not. Other examples could be given where young people have a choice between no financial assistance for studies (neither grants nor loans) when their parents are well off, and the sum of $1 758 if they do are social aid beneficiaries. Where their parents are social aid beneficiaries, young people received $1 250 in grants and $1 195 in loans if they are studying in CEGEP, or $1 758 if they are social aid beneficiaries.

The problem arises from the fact that under the student assistance program, CEGEP or university undergraduate students are considered to be dependents; under the social aid program, they are deemed to be self-sufficient, and receive assistance. Thus, under the student assistance program, it is assumed that parents will make a contribution if they are financially able to do so; the opposite is true under the social aid program. As has been shown, young people between 18 and 20 who receive transfers are, nontheless, considered to be dependents under the Québec and federal taxation systems, and a full exemption for dependent children is granted with respect to them.

To bring the tax system and the transfer system into harmony, young people 18 to 20 should be considered dependents in the transfer system, as is the case with the student assistance program and the tax system. Thus young people whose parents' income was below the zero taxation floor would be entitled to transfers which would be paid either directly to them or to their parents, depending upon the policy adopted. These amounts would correspond to the accepted level of essential needs for children and would vary according to the option: $1 596 under option I, $1 248 under option II and $1 278 under option III. No transfers would be paid to young people 18 to 20 whose families paid income tax. However, once the reform has been implemented, those from among that group who will have attained 18 years of age before the new income guarantee program takes effect would continue to receive the benefits they are entitled to under the current system.

The proposed tax system still considers young people 18 to 20 to be dependents and grants their parents an exemption equivalent to that for other children: $1 668 for the first child and $1 224 for the second and each subsequent child. The exemption allowed in 1983 under the present system is $1 260. In this way, the systems which apply to young people between 18 and 20 would be made more consistent and the financial incentive to leave school for social aid would be removed. For children aged 21 or over at school, as for all dependents aged 21 or over, the exemption of $1 260 is raised to $4 177, which is the equivalent of the dependent's exemption. However, the income immunity which does not reduce the exemption ($2 800 in 1983) is abolished; the first dollars earned will reduce it.

The tax exemption on the first $500 of grants or academic scholarship is unjustified. It may lead to a situation, particularly for students who graduate and enter the job market, where, on similar annual income, two graduates do not pay the same taxes. The student who has received government assistance has an advantage. It is proposed, in the event that the student assistance program is reorganized, to allow tuition fees which are now deductible during the current year by the student to be carried over from one year to the next and transferred to the parents for tax deduction purposes.

5.2.2 Persons 65 or over

The analysis in Part I showed that the elderly benefit from several programs across the entire income scale. When they have retired and are without private pension income, in addition to an old age pension, the federal government pays a non-taxable guaranteed income supplement, which assures recipients basic transfers which are markedly higher than amounts currently provided under other transfer programs for those under 65. However, if such individuals have been working, they will have accumulated funds in the Québec Pension Plan which entitle them to benefits. If they have other savings for their retirement, assets which will result in pension or investment income, such income will also be subject to considerable tax advantages, including deduction of the first $1 000 in interest and dividend income, and the first $1 000 in private pension income. In addition, there exists a $2 100 age exemption for everyone who is 65 or over (in 1983), which can be transferred from one spouse to the other.

Senior citizens also have access to government housing assistance programs (reception centres, low-cost housing, LOGIRENTE). Additional needs arising from their state of health are covered by a comprehensive, free health and hospitalization insurance program, and by comprehensive programs providing free prescription drugs and free ambulance services.

All of these benefits provide the elderly with disposable income superior to that of those under 65, across the entire tax curve, from the poorest to the wealthiest. Given these conditions, it does not seem necessary to include further benefits to senior citizens in this reform. However, it would be inconsistent for the basic principles of the reform not to apply to them. Changes in basic personal and spouses' exemptions presented under the reform also apply to those 65 or over, and similarly with respect to the sales tax credit and the property tax deduction.

Furthermore, the tax reduction which aims at raising the zero tax threshold would also apply to persons 65 or over. However, the $2 100 age exemption would no longer apply to those who have not left the labour market, in keeping with the new legislation abolishing compulsory retirement. The effect of these changes would be to bring persons 65 or over who are still working under the same tax system as workers under 65. The tax thresholds for senior citizens who have retired, especially for those who have accumulated a retirement fund, would remain higher than those applicable to younger people who are still working. Tax thresholds for retired senior citizens are compared with those for persons under 65 in Table V.8, while Chapter VI analyses the overall impact of the reform on the net contribution of senior citizens to the financing of public expenditures.

5.2.3 Housing assistance programs

The programs being considered in this area are LOGIRENTE, low-rental housing, and the supplement granted to the handicapped and special assistance to victims of urea formaldehyde foam insulation (UFFI). The problems outlined previously centre around the fact that it is preferable to emphasize assistance policies intended for those for whom the cost of housing is too burdensome in relation to their income, rather than favour one group of taxpayers at the expense of others. It has also been shown that the housing needs of social aid recipients living in low rental housing are being covered twice.

The discussion generated by the Green Paper on housing policy will help to lay out a more definite plan of action in this area. The problem of double coverage of certain needs related to housing can be solved easily, either by reducing the social aid benefit or by increasing the rent payable. As for the other problems related to the housing assistance programs, they also fall within the realm of housing policy.

Table V.8

Comparison of tax thresholds'[1] of retired taxpayers 65 or over with those applying to taxpayers under 65 according to the various options

	Current situation	Option I	Option II	Option III
Taxpayers under 65				
• Single people between 30 and 64[1]	5 130	7 795	7 795	8 550
• Childless couple between 30 and 64[1]	8 900	12 284	12 847	14 426
Single person 65 or over				
• Exemptions and general deductions	5 130	5 451	5 451	6 320
• Age exemption	2 100	2 100	2 100	2 100
• Employment-related expenses	—	—	—	—
• Tax reduction	—	1 719	2 344	2 231
• Zero tax threshold without other retirement income	7 230	9 270	9 895	10 651
• Retirement income deduction[2]	1 000	1 000	1 000	1 000
• Maximum non-taxable income	8 230	10 270	10 895	11 651
Couple 65 or over				
• Exemptions and general deductions	10 260	9 534	9 534	11 272
• Age exemption	4 200	4 200	4 200	4 200
• Employment-related expenses	—		—	—
• Tax reduction	—	2 750	3 313	3 154
• Zero tax threshold without other retirement income	14 460	16 484	17 047	18 626
• Retirement income deduction[2]	1 000	1 000	1 000	1 000
• Maximum non-taxable income	15 460	17 484	18 047	19 626

1. For comparison purposes, employment-related expenses have not been considered for those under 65.
2. The amounts of the deduction are established for the case where only one spouse has retirement income; they could double in the event both spouses had such income, as they are transferable from one spouse to the other. Moreover, the deduction of the first 1 000 $ in interest and dividend income is not considered.

5.2.4 Integration of the tax and transfer systems

It is hardly necessary to point out the problems posed by the lack of integration of tax and transfer systems, and among various transfer programs. The most serious problem arises with regard to the incentive to work, and results from the addition of the marginal income tax rates and the reduction rates of transfers as employment income increases.

It is on the basis of this observation that the whole personal tax and transfer systems will be revamped. The guiding principle is, therefore, to integrate the tax and transfer systems so as to ensure that the tax system never intervenes at the same time as transfer programs related to income. Stated otherwise, the system must be constructed so that at a given level of income, the individual or household can only benefit from transfers, or pay taxes. This is the only way to avoid cumulative totals of marginal rates and the attendant anomalies with regard to the incentive to work.

The first step in obtaining this result is to standardize definitions. Second, it is necessary to ensure that various elements which lead to non-taxation (personal exemptions, tax reductions, automatic exemptions, tax credits and so forth) are compatible with those which lead to the cessations of payment of transfers (non-availability benefits and rates of reduction). The consequences of integrating the tax and transfer systems for the methods of indexing, other transfer and administrative methods must also be examined.

5.2.4.1 Standard definitions

It becomes very hard to make the transfer programs compatible with each other and with the tax system when criteria for defining the ability to pay are different. In Part I, it was shown that such a situation led to all sorts of anomalies; it tends to make the tax and transfer systems less equitable, increases the cost of running them, and makes them incomprehensible to most taxpayers.

First, it is necessary to adopt identical definitions of income, with respect to the tax and transfer systems. However, with regard to income generated by assets, complete harmonization is impossible, as it is the concept of assets rather than income from assets which must act as a criterion in the case of transfer programs. On the other hand, there is every reason to standardize policies respecting the manner in which assets are taken into account under the transfer programs.

As for the basic declaration unit, complete harmonization is not possible between the tax and transfer systems. As was explained earlier, the basic unit under the transfer system should continue to be the household, while the individual and dependents should be the unit under the tax system. However, it is possible to appreciably reconcile the two definitions by counting as dependent for income tax purposes the same individuals as those who make up the household considered with respect to transfers. The proposed reform would make great strides in this direction: recognition of de facto spouses by the tax system, and inclusion of young people between 18 and 20 as dependents in the household considered with respect to transfer programs. These changes would lead to the disappearance of the major sources of variance between the two definitions.

Third, definitions of essential needs must be harmonized, with respect to basic programs for which Québec is responsible, and supplementary programs.

It appears harder to standardize the accounting period for resources and needs. On the one hand, there is no question of asking taxpayers to file a tax return more than once a year. On the other, the period of one year is much too long to satisfactorily administer the transfer system. When a household's income is suddenly reduced, it cannot wait a year for payments which will ensure them sufficient funds to live on: its essential needs are much more immediate.

Just as the tax system operates on the basis of **instalments**, it will be necessary for the transfer system to include a similar feature. Benefits paid by the transfer system would be granted on the basis of a monthly evaluation of needs and income, as is currently the case with respect to social aid. Other transfer programs would have to be similarly modified. At the end of the year, income tax paid in instalments and transfers received during the year would be reconciled, probably when income tax returns are filed. In this way, the calculation of the final amount to be paid or collected would ensure that, *a posteriori*, the system operates on an annual basis.

As opposed to the current property tax refund which is paid once a year when personal income tax is calculated, the new sales and property tax credits would be paid regularly throughout the year in instalments subject to a final calculation made at the end of the year in along with the personal income tax return. These instalments could be built into the system of deductions at source or the monthly payments of the income guarantee program, or into special monthly or quarterly payments to individuals. This would have the advantage of allowing the taxpayer to benefit much more quickly from the refunds he is entitled to and which are related to needs which occur throughout the year.

5.2.4.2 Compatibility between the zero tax threshold and the zero transfer cutoff point

As was pointed out earlier, it is essential that the taxation system and transfer programs not apply simultaneously. As a taxpayer's income increases, his transfers will decrease gradually; once transfers have been completely exhausted, he will start to pay income tax. The following equation must apply to every taxpayer:

Zero tax threshold = Zero transfer cutoff point

The amount of income on which the taxpayer begins to pay taxes is equal to the sum of:

Zero tax threshold = Personal exemptions
+ Deductions for child care expenses
+ Unemployment insurance and QPP contributions
+ Standard deduction from employment income
+ Income which obviates the effect of basic credits for sales taxes
+ Income which obviates the effect of the lump-sum tax reduction

On the other hand, the amount of income on which the taxpayer ceases to receive transfers depends on the rate of reduction of transfers which applies when his income increases. It should be noted that this income is net of unemployment insurance and QPP contributions as well as the standard deduction from employment income. The cutoff point is equal to:

Zero transfer cutoff point =

$$\frac{\begin{array}{l}\text{Non-availability}\\\text{benefits}\\\text{under}\\\text{income}\\\text{guarantee}\\\text{program}\end{array} + \begin{array}{l}\text{Benefits}\\\text{for child}\\\text{care}\\\text{expenses}\end{array} + \begin{array}{l}\text{Basic}\\\text{tax}\\\text{credits}\end{array}}{\text{Rate of reduction of transfers}}$$

Obviously, the zero tax floor and the zero transfer cutoff point can only be equal if an adjustment is made to the tax side of the equation. As was noted earlier, it would have been possible to adjust personal exemptions accordingly, but simulations carried out indicate that it would be necessary to more or less double such exemptions, which would be very costly.

It seemed preferable to maintain the principle of personal exemptions equal to the cost of short and long-term essential needs and needs which are important but nonessential, and make the adjustment by less costly means. This is the objective of the lump-sum tax reduction included in the calculation of the zero tax threshold and which was mentioned in the presentation of the overall framework, which lowers taxes in such a way as to make the zero transfer cutoff and the zero tax floor equal. This lump-sum tax reduction will vary according to the size of the household, as the different elements of the foregoing equation vary in the same way: the zero transfer level goes up as the size of the household increases. The tax lump-sum tax reduction must also vary with each option, as the level of the non-availability benefits and the transfer reduction rate are not the same, thereby shifting the transfer cutoff.

In addition to the lump-sum tax reduction mechanism, a second element must be set up to ensure the equality of the zero transfer cutoff and the zero tax threshold in the case of households which incur child care expenses. This entails having the level of income at which the subsidy for child care expenses disappears coincide with that at which income tax must be paid. As no tax reduction is added to the tax deduction for child care expenses, the subsidy granted households receiving income guarantee program benefits must be lower than the tax deduction which, in turn, must be the same as the amount of expenses actually incurred. That is why options II and III use a subsidy equal to 50% of child care expenses while under option I, the rate of reduction is 67% (as is the rate of reduction of transfers). Under options II and III, this method has the advantage of granting a more or less equal government contribution to households which incur child care expenses across the entire income scale, whether in the form of a benefit or a deduction. Under option I, assistance to low-income earners is greater; on the other hand, the high marginal rate of 67% reduces the incentive to work.

5.2.4.3 The method of indexation

Another characteristic of the reform to be adopted, which is aimed at maintaining the zero tax threshold and the zero transfer cutoff at the same level, entails adopting uniform methods of indexation. At present, a number of transfers are indexed automatically, on a quarterly or annual basis. On the other hand, income taxes are indexed annually, on a discretionary basis. If both systems continue to operate independently of each other, harmonization of the tax and transfer system will be only temporary.

In choosing a common method of indexation, despite the advantages concerning financial flexibility the government gains through the discretionary formula, it would be desirable that the new system be based on an indexation formula which would depend on changes in inflation, or the earnings of low-income workers.

Regardless of the method chosen, it should, ideally, include an annual indexation rate which applies equally to the taxation system and the transfer system.

Indexation should apply property and sales to benefits, personal exemptions, lump-sum tax reductions, tax credits and deductions for child care expenses and property taxes, as all of these elements affect the level of the zero transfer cutoff or the zero tax threshold. To ensure fairness, it would, moreover, be necessary to index all deductions linked to the ability to pay.

5.2.4.4 Benefits paid under other programs

The current social aid program represents a last resort for an individual who does not have sufficient financial resources to meet his essential needs. The new income guarantee program would play the same role.

At present, unemployment insurance benefits, CSST benefits and other transfers are generally higher than social aid benefits. However, it may happen that low-income earners receive various of these social assistance benefits, and are also eligible for the social aid program, with the latter making up the difference in needs.

Table V.9

Operation of the income guarantee program
With respect to a family with two children under 12 under option II
Employment income of 5 000 $ with or without unemployment insurance benefits
(in dollars)

Income guarantee program benefits	**With 3 000 $ unemployment insurance benefit**	**Without unemployment insurance benefits**
• Essential needs recognized under the income guarantee program	8 424	8 424
— Less sales tax credit	(160)	(160)
— Less federal transfers paid to family		
— family allowances	(684)	(684)
— child tax credit	(686)	(686)
— unemployment insurance	(3 000)	—
— Gross benefit under income guarantee program	3 894	6 894
— Less 50% of net employment income[1]	(2 264)	(2 264)
— net benefit under income guarantee program	1 630	4 630

[1] Employment income of 5 000 $ net of QPP and UIC contributions, and the deduction for employment-related expenses (6% of employment income, maximum 750 $).

The zero transfer cutoff of the income guarantee program will be even higher than that under the social aid program. The transfer benefits will be treated as though they cover the individual's or the household's essential needs; the amount of income guarantee program benefits will be treated as a supplement, as is currently the practice. Table V.9 outlines this procedure.

5.2.4.5 Administrative integration

Administrative integration arises from the combination of both systems. Were it only for purposes of administering the year-end income tax return which would set out transfers received, income tax paid and amounts due, administrative integration is essential. It is hard to conceive of the tax return passing from the ministère du Revenu to the ministère de la Main-d'Oeuvre, or the ministère de l'Éducation, for verification of each of its components. It is preferable for a single department — the ministère du Revenu, for example — to do so.

On the other hand, it is obvious that at least two different systems would be affected by the ongoing management of instalments. It cannot be asked of the ministère du Revenu to administer the income guarantee program, yet it is hard to see who else might oversee contributions and income tax refunds. As a result of separately administering various instalments, information belonging to these departments should be communicated to the central department as a means of controlling year-end income tax returns, as is currently the case under the taxation system, where all employers forward relevant information to the ministère du Revenu at the end of the year. Consequently, possible tax evasion under such an administrative system would be substantially reduced in relation to what is possible under the present system.

Notwithstanding this advantage for the government, taxpayers would find the system's simplicity, their ability to understand it and their willingness to comply with it, highly advantageous.

5.3 The Options for Reform

So far in this chapter, we have looked at the main framework of the reform as well as its features and guiding principles. Given the complexity of the proposed options and the interrelationships among each of their elements, it is worthwhile, to make the whole package easier to understand, to give a summary description of each of the reform options put forward in the *White Paper*.

Each of the three reform options entails that the government draw from a $600 million cushion to attain its objectives (incentive to work, competitive tax system, guaranteed income, economic efficiency and redistribution of income). With this cost constraint as a starting point, the government has laid out a number of options which will allow it to attain the goals we have just enumerated. All the options share certain common elements designed to remedy particular problems in the personal tax and transfer systems. In addition, each has its own distinctive elements aimed at specific objectives. Thus, for example, some options put a greater emphasis on a guaranteed basic minimum income, while others utilize the government's cushion to generate a stronger incentive to work.

The reform may be summarized by grouping those elements which are common to all the options, and then considering the elements which are distinctive to each. Finally, Table V.10 and V.11 set out and compare the features of each option as well as their principal distinctive elements.

Two things should be kept in mind before proceeding any further. First, the data presented in this section, and in particular in Tables V.10 and V.11, do not constitute final positions. They are provided solely to illustrate the major elements of the reform, whose impacts will be presented in Chapter VI. Although it is important to lay out the features of the reform as accurately as possible, the public debate must focus above all on the principles underlying the various options.

Second, it must be borne in mind that the reform as we have described it represents the end point of a more or less lengthy implementation process. Once a consensus has been reached on the reform, a transitional implementation phase will ensue, whose duration will depend on conditions in the labour market, and the government's financial lee way. The situation immediately following the implementation of the reform will be outlined in Chapter VI.

5.3.1 Common elements

The three options which the *White Paper* has proposed put forward a core of common elements with respect to the tax system, the transfer system and the integration of the two. Nevertheless, there are certain variations in these common elements, as illustrated in Table V.11 which sets out the main components of each option with respect to the tax system.

5.3.1.1 The tax system

The *White Paper* is proposing the following common measures with respect to taxation:

a) A reform of the system of personal exemptions such that, for each household type, the income necessary to cover essential needs is free of tax, and such that certain problems in the current tax system are corrected. This entails:

   — setting the basic personal exemption equal to the level at recognized essential needs;

   — making the basic personal exemption and the married exemption equal so as to bring the exemptions available to couples with both spouses working into line with those available to couples with only one spouse working;

   — extending the married exemption to de facto spouses;

   — bringing in a new exemption to compensate for the extra needs of persons who live alone in a separate dwelling;

   — the introduction of a new exemption for dependent children under 21. This exemption would range between $1 224 and $1 698, depending on the option and the position of the child. The existing family allowances would be maintained for households which so request it. The amount thus received would be taken into account in the amount of benefits paid to the household or of taxes it pays. The current availability allowance would be maintained for children under two;

   — increasing the exemption for other dependents and introducing a new exemption for the first child of a single-parent family to replace the current family support exemption.

b) A reduction in the marginal income tax rates applicable to all taxpayers generally, and in particular to middle and high-income earners in order to make Québec's tax system more competitive with Ontario's.

c) An increase in the general employment expense deduction from 3% to 6% of employment income, with a ceiling of $750 rather than $500.

d) Reworking the child care expense deduction so as to take fuller account of child care expenses actually incurred:

   — by raising the limit for children under 6 from $2 000 to $3 120 (in 1983 dollars);

   — by setting the limit for children from 6 to 11 at $1 560;

   — by allowing the spouse with the higher income to claim the deduction;

   — by abolishing the deduction for children 12 to 14.

e) Bringing in a new system of tax credits designed to compensate for property and sales taxes paid by low-income households on their essential needs.

5.3.1.2 The transfer system

The three options present the following common measures concerning the transfer system:

a) The creation of a single income guarantee program for persons able to work, which would consolidate the various programs currently in effect: social aid, the employment income supplement, child care assistance, family allowances, availability allowances and the property tax refund.

b) An improvement in the situation of low-income workers in order to encourage them to hold their jobs by way of a employment income supplement within the larger income guarantee program and by the elimination of tax as long as these workers are entitled to transfers; the extension of the employment income supplement to persons under 30.

c) A money incentive for upgrading the "employability" of income guarantee program beneficiaries by way of additional benefits for all beneficiaries who follow a program for reintegrating themselves into the labour market (industrial training, further education, community work, etc.), in conformity with the programs recently approved by the government.

d) Setting the ordinary benefits under the income guarantee program in accordance with the average expenses incurred by low-income households to cover their essential needs. Beneficiaries who participate in a program to upgrade their "employability" would be eligible for child care assistance to be added, when necessary, to the ordinary benefits.

e) The continuation of the current social aid program for persons considered unable to work, with the possibility of voluntary admission to the new income guarantee program if such is their choice; introduction of a special assistance program for persons temporarily unable to work.

f) A closer integration between the student assistance program and the new income guarantee program by including the income of parents in the benefit calculation for income guarantee beneficiaries 18 to 20. This measure would only apply to beneficiaries who have not turned 18 at the time the reform comes into effect.

g) A major reworking of the child care expense subsidy which will cover, according to the option chosen, between 50% and 67% of expenses incurred. Maximum eligible expenses are $3 120 for pre-school children, and $1 560 for children from 6 to 11. The subsidy would be open to low-income workers and to those participating in reintegration activities. It would be incorporated into the benefits such low-income households would receive under the income guarantee program, and would be subject to the same transfer reduction rate when the beneficiary earns employment income.

h) The extension of the child care expense subsidy to cover children in all types of child care services and not only those in establishments licenced by the Office des services de garde à l'enfance.

5.3.1.3 Measures for integrating the tax and transfer systems

a) Harmonization of the level of essential needs recognized under the income guarantee program with the level of needs recognized through personal exemptions.

b) A lump-sum tax reduction designed to raise the tax threshold and prevent the simultaneous application of the tax system and the transfer system. Thus, an individual would not pay taxes as long as he was receiving income guarantee program benefits, and would continue to receive transfers as long as his income was not high enough to incur tax.

c) A common indexation for the tax and transfer systems. Personal exemptions and social benefits would be indexed at the same rate.

d) The tax and transfer systems would share common or at least compatible definitions of income, assets, recognized needs, declaration unit and accounting period.

e) A system of administration which would make possible the annual reconcilation of the sums received monthly and paid regularly by the taxpayer with respect to both the tax and transfer systems.

5.3.2 Distinctive elements

As we have just seen, each of the reform options makes use of a $600 million cushion and is centred about a number of common elements which we have just listed. Despite these various common elements, each of the options presents a distinct and original approach to solving the problems inherent in the tax and transfer systems and, depending upon the particular social and economic objectives pursued, deals with the following fundamental questions in very different ways: the level of benefits and of essential needs recognized for the unemployed, marginal transfer reduction rates for persons with low income or who are entering the labour market, the progressivity of the table of marginal income tax rates, the average tax rates of various taxpayers and, finally, the extent to which sales taxes should be used to finance government expenditures. A rough description of the various options follows (see also Table V.10):

Table V.10

Principal distinctive elements of the various options

Option	Essential needs covered by income guarantee program benefits[1]			Implicit marginal tax rate on low-income earners	Maximum marginal tax rate on high-income earners[3]	Minimum income subject to maximum marginal tax rate	Income tax reduction	Broadening of sales tax base	Zero tax threshold[4]
	Active persons[2]	Persons active but not available	Persons not available						
I	In excess of short and long-term	Short and long-term	Short and long-term	67%	58.4%	69 773 $	Average	No	16 005 $
II	Short and long-term	Short-term plus clothing	Short-term	50%	58.4%	70 562 $	Average	No	16 588 $
III	Short and long-term	Short-term plus clothing	Short-term	50%	56.4%	71 760 $	High	Yes	18 948 $
Present system	Short and long-term essential needs			75% to 100%	60.4%	60 714 $			11 918 $

1. Short-term essential needs consist of current expenditures requiring at least monthly expenditures, such as food, housing, communications, household services and personal services Long-term essential needs include those which do not occur on a regular basis, such as furniture and clothing. Important but nonessential needs include expenditures for public transportation, recreation and reading material.

2. Persons who take part in a reintegration activity.

3. Including federal income tax.

4. The zero tax threshold shown applies to a married taxpayer with two children between 6 and 11, whose spouse does not work outside the home.

OPTION I

— Relatively generous ordinary benefits which automatically cover short and long-term essential needs for all income guarantee program beneficiaries whether or not they are available to search for employment or participate in reintegration activities (professional or academic training, on-the-job industrial training, community work).

— A relatively high reduction rate of transfers (67%) per dollar earned is maintained for low-income workers.

— A reduction in marginal tax rates.

— The current situation with respect to sales taxes is maintained.

OPTION II

— Option II also provides coverage of essential short and long-term needs but, in return, it requires that those income guarantee beneficiaries able to work take part in a reintegration activity or work part-time. A level of ordinary benefits covering short-term essential needs plus clothing applies to beneficiaries who are able to work, are available for reintegration activities or to search for work, but do not participate in such an activity. Beneficiaries who are able to work but not available for reintegration activities or to search for work will receive lower benefits equivalent to short-term essential needs.

— For low-income workers, a lower reduction rate of transfers per dollar earned (50%).

— A reduction in marginal tax rates.

— The current situation with respect to sales taxes is maintained.

OPTION III

- Sales taxes would be extended to include all consumer goods except food, prescription drugs and professional services.
- The level of benefits is based on the same principles as under option II. They are somewhat higher, however, to compensate for the higher sales taxes which low-income taxpayers would pay on their purchases of goods to satisfy their essential needs as a result of the broadened sales tax base.
- Low-income workers would see the reduction rate or transfers significantly cut back to 50%.
- A significant reduction in marginal tax rates.

We now proceed with a more detailed description of how each of the options addresses the fundamental questions previously enumerated.

5.3.2.1 Option I

Option I is more traditional in the sense that it automatically provides coverage for beneficiaries' short and long-term essential needs without requiring them to participate or be available to participate in activities to help them become reintegrated into the labour market. The same income guarantee program benefits apply to persons who are available to take part in reintegration activities as to those who are not. These benefits are about equal to those under the current social aid program.

Under the current system, the combined effect of the reduction in transfers and the increase in taxes is such that a social aid beneficiary who returns to work loses almost all the extra income he earns, especially if he is working at the minimum wage. His implicit marginal tax rate is thus 100% or 75% if he receives work income supplement benefits.

Option I does little to increase the incentive to work, both because of the level of benefits it provides and the 67% implicit marginal tax rate it applies. If option I is chosen, an income guarantee recipient who accepts a job at the minimum wage would retain only 33% of the extra income he earns.

Insofar as income tax is concerned, option I provides greater incentive to work by raising the tax threshold for individuals. For example, under the current tax system, a married taxpayer with two children between 6 and 11, whose spouse does not work outside the home, pays no Québec income tax as long as his income is below $11 918. Option I would raise this family's zero tax threshold to $16 005.

The number of taxable income brackets and the progressivity of the tax table have both been reduced. Taking the 3% general tax reduction into account, Québec's maximum marginal tax rate has been cut back from 32% to 30%.

Finally, Option I does not envisage any changes with respect to sales taxes.

5.3.2.2 Option II

There is a significant difference between option II and option I in that, under option II, a beneficiary is required to participate in a reintegration activity or to work part-time to ensure that his short and long-term essential needs will be covered. The amount of benefits for persons who are not available to undertake such an initiative will be reduced to what is needed to cover their short-term essential needs. In most cases, these benefits are roughly equivalent to those paid to beneficiaries in Ontario. Finally, under option II, beneficiaries who are available to undertake a reintegration initiative are guaranteed that their benefits will remain at their current level during the initial implementation of the reform, until they are equal to what is required to cover their short-term essential needs plus clothing.

By reducing non-availability benefits to a level corresponding to short-term needs, option II succeeds in reducing the marginal transfer reduction rates and makes a return to the labour market or participation in reintegration activities financially more worthwhile. Implicit marginal tax rates are cut back to 50% compared with virtually 100% under the current system and 67% under option I. Option II thus allows the income guarantee program recipient to keep a substantial portion of his gains from employment, and so increases his incentive to work.

The differences between options I and II with respect to taxation are not nearly as significant. Under both options, the tax table contains marginal rates which vary from 16% to 30%. However, there are slight differences in taxable income brackets, as indicated in Table V.4. The tax zero threshold under option II is slightly higher than under option I. For a married taxpayer with two children between 6 and 11 and whose spouse does not work outside the home, his tax threshold under option II, option I and the current system is $16 588, $16 005 and $11 918 respectively.

Option II does not modify the sales tax structure in any way.

5.3.2.3 Option III

As opposed to options I and II, option III makes much greater use of consumption taxes. By applying a sales tax to all consumption goods, other than food, prescription drugs and professional services, an additional $900 million cushion would be generated which the government could use to pursue its objectives of incentive to work and economic efficiency much further than under options I and II.

Under option III, this sizable additional cushion would be employed to provide a greater reduction in tax rates for all taxpayers. The tax table under option III imposes the lowest marginal tax rates, ranging from 13% to 28%, compared with a spead of 16% to 30% under the other options. Taxes would be reduced across the board under option III, but the reduction would be particularly significant for middle and high-income taxpayers. This option thus concentrates on increasing the incentive to work at all income levels and on making Québec's tax system more competitive. In addition to its lower marginal tax rates, the tax threshold under option III is higher than under options I and II. Turning once again to our standard example (married taxpayer with two children, whose spouse does not work outside the home), this taxpayer would not pay income tax until his income reache $18 948, compared with $11 918 under the current system and roughly $16 000 under options I and II.

As is the case under option II, transfers to persons who are not working would cover short and long-term essential needs, under option III, only in the case of those who participate in upgrading activities. Beneficiaries who are available are entitled to ordinary benefits which, once the reform has been fully implemented, will cover the cost of essential short-term needs, plus clothing needs, while beneficiaries who are not available are only entitled to essential short-term needs. With respect to low-income workers, option III provides a greater incentive to work than does the current system by holding implicit marginal tax rates at 50%, which is comparable to option II.

Table V.11

Tax system
Principal elements of the various reform options (1983)

Elements	Current system	Option I	Option II	Option III	Remarks
1 Changes in taxable income					
1.1 Personal exemptions					
1.1.1 Basic exemption	5 030 $	4 392 $	Idem	4 482 $	— Equal to spouse's exemption — Includes 215 $ deduction for property taxes
1.1.2 Spouse's exemption	3 770 $ less spouse's net income (for income tax purposes) in excess of 1 360 $	4 392 $ less spouse's net income	Idem	4 482 $ less spouse's net income	— Each dollar of the spouse's income reduces the exemption — Includes 215 $ deduction for property taxes
1.1.3 Exemption for each dependent child					
• 18 or over	1 260 $ less net income (for income tax purposes) in excess of 2 800 $				
• 16 or 17	770 $ less net income (for income tax purposes) in excess of 2 800 $	1 668 $ for the first + 1 224 $ for each of the others less the dependent child's net income	Idem	1 698 $ for the first + 1 254 $ for each of the others. less the dependent child's net income	— Each dollar of the dependent child's net income reduces the exemption — Includes 55 $ deduction for property taxes
• Under 16	None				
1.1.4 Age exemption	2 100 $ per person 65 or over	Maintained for those who are retired	Idem	Idem	
1.1.5 Exemption for other dependents 21 or over (including children)	1 260 $ less net income (for income tax purposes) in excess of 2 800 $	4 177 $ less the dependent's net income	Idem	4 267 $ less the dependent's net income	
1.1.6 Special exemption for person living alone in a separate dwelling	None	684 $	Idem	Idem	
1.1.7 Equivalent to married person exemption	3 770 $ less net income (for income tax purposes) in excess of 1 360 $ for the first child of a single-parent family	Abolished and replaced with one of the following proposals (to be determined):			
		Proposal A: Exemption equal to spouse's exemption plus child care allowance equal to 67% of cost incurred Proposal B: Exemption equal to 150% of exemption for first child, plus child care allowance equal to 100% of cost incurred	Idem with the exception that under assumption A, the child care allowance is set at 50% of costs incurred.	Idem	The terms are set out more explicity in Section 7.4.3.

Table V.11 (continued)

Tax system
Principal elements of the various reform options (1983)

Elements	Current system	Option I	Option II	Option III	Remarks
1.2 Changes in the deduction for employment-related expenses	3% of employment income, up to 500 $	6% of employment income, up to 750 $	Idem	Idem	
1.3 General deduction of 100 $	Automatic deduction of 100 $	Abolished	Idem	Idem	
1.4 Deduction for tuition fees	Only the student may claim the deduction; it is not transferrable to a parent or other person claiming the student as a dependent. The deduction may not be carried forward, or backward.	The deduction would be transferrable to a parent or other person claiming the student as a dependent, and could be carried forward or backward.	Idem	Idem	
1.5 Income from grants and scholarships	First 500 $ of income from grants and scholarships is exempt	The exemption is abolished	Idem	Idem	
1.6 Deduction for child car expenses	Granted for children under 14 receiving child care. The deduction is limited to the least of the following — costs actually incurred: — 2 000 $ per child and 6 000 $ per family — ⅔ of employment income of the spouse with the lesser income The deduction must be claimed by the spouse with the lesser income.	Granted for children 11 and under receiving child care. The deduction is limited to the least of the following: — costs actually incurred — 3 120 $ for children under 6 — 1 560 $ for children 6 to 11 — 40% of the employment income of the spouse with the lesser income The deduction may be claimed by the spouse with the higher income.	Idem	Idem	

Table V.11 (continued)

Tax system
Principal elements of the various reform options(1983)

Elements	Current system	Option I	Option II	Option III	Remarks
2 Change in tax payable					
2.1 The tax table	Marginal rates range from 13% to 33% of taxable income.	Marginal rates range from 16% to 30% of taxable income; number of tax brackets reduced.	Idem	Marginal rates range from 13% to 28% of taxable income; number of tax brackets reduced.	
2.2 General 3% tax reduction	In effect	Incorporated into the new tax table	Idem	Idem	
2.3 Lump-sum tax reduction					
2.3.1 Person living alone	None	275 $	375 $	290 $	The lump-sum reduction is refundable and is limited to the amount of tax payable.
2.3.2 Single person sharing a dwelling	None	220 $	265 $	205 $	
2.3.3 Couple	None	440 $	530 $	410 $	
3 Changes in tax credit					
3.1 Québec family allowances	Monthly payment ranging from 7.90 $ to 15.80 $ according to child's seniority, limited to children 17 and under.	System of exemptions for dependent children or family allowances (basic choice discussed in Chapter VII)	Idem	Idem	
3.2 Québec availability allowance	Annual payment of 300 $ for the first child, 200 $ for the second and 100 $ for each additional child, payable to the mother, for children under 6, instead of the child care expense deduction (if more advantageous)	Maintained for children under 2, using the amounts currently in effect.	Idem	Idem	
3.3 Sales tax credit	None	Basic: 60 $ Spouse: 60 $ Per child: 20 $ The credit is reduced at the rate of 3% of income in excess of the zero tax threshold.	Idem	Basic: 150 $ Spouse: 150 $ Per child: 50 $ The credit is reduced at the rate of 3% of income in excess of the zero tax threshold.	The zero tax threshold equals the taxpayer's personal exemptions *plus* deductions for employment;related expenses *plus* income nullifying the effect of the sales tax credit and lump-sum tax reduction (see section 5.2.4.2).
3.4 Property tax credit	Currently, the credit equals 40% of property taxes paid on the household's principal residence (1 000 $ maximum), less 2% of the household's net income as calculated for the property tax refund. This net income is equal to 90% of the household's total income (including transfers) less its total personal exemptions. The maximum credit is 400 $.	A new property tax credit is introduced, equal to 40% of the property taxes paid on the principal residence in excess of the property tax deduction (800 $ maximum) less 2% of income is excess of the zero tax threshold. The maximum credit is 320 $.	Idem	Idem	

The Impact of the Proposed Reform

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Chapter VI
The Impact of the Proposed Reform

The proposed reform is sweeping and will implement numerous measures which will not only modify Québec's taxation system, but will also considerably change the system of transfers to individuals. In order to properly judge the reform, it is important to assess the effects of various options in light of the underlying objectives outlined in Chapter I of this document, that is, maximum fairness and acceptable redistribution of income, economic efficiency, the incentive to work and the adoption of a more competitive tax system.

Before discussing the impact of the reform with respect to achieving various objectives, it is important to first indicate its impact on taxpayers and to identify the effects of the reform on income guarantee program beneficiaries both following its initial implementation and when it is fully operational. These are the first aspects of the reform dealt with in this chapter, as taxpayers are primarily interested in knowing whether, under the new system, they will have to pay more or less to finance government services, and beneficiaries are concerned to know whether their transfers will be reduced or increased, on the basis of income, civil status or other characteristics, and in terms of net contribution to State financing and average and marginal tax rates.

In seeking to be fair, Québec's tax system is characterized by various problems related, among other things, to the **taxpaying unit***, the definition of the ability to pay, or the recognition of certain deductions (for example, child care expenses), and the treatment for purposes of taxation which varies among different categories of taxpayers with similar incomes. Section 6.2 describes the effect of the various measures under study to make Québec's tax system more equitable.

On the other hand, any system of taxation alters the allocation of resources and negatively affects economic efficiency (disincentive to work, development of an **underground economy** and so forth). Section 6.3 attempts to assess to what extent the **economic losses** engendered by the current system might be reduced through various options, and to what extent the implementation of the proposed system might improve output and employment.

However, the choice of the best possible reform must not be based exclusively on economic criteria. Redistribution of income is also an important criterion for assessment. Increased efficiency is often accompanied by a deterioration in the distribution of income. However, as disparities in employment income are the determining factor in income distribution and the reform is aimed, among other things, at making the labour market more attractive to low-income earners it may well be, in the medium term, that the conflict between economic efficiency and the fair distribution of income, between the level of overall output and its distribution among individuals, will disappear. Section 6.4 assesses to what extent each of the options under consideration will lead to the redistribution of income.

To conclude, the effects of the reform on the government's financial framework will be examined.

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* Terms in boldface type are defined in the glossary.

6.1 Impact of the Reform on the Fiscal Situation of Households

Part I of the *White Paper* presented an analysis of Québec's tax and transfer system based on fiscal indicators which made it possible to delineate certain of its characteristics. The same indicators will be employed in this section to illustrate the impact of the reform on certain typical taxpayers, and to compare the new financial and tax situation of individuals according to their income, with that prevailing under the current system.

This methold of analysis, based on the use of fiscal indicators, is, however, purely static in nature: it is supposed that individuals continue to earn the same gross income, and that the new fiscal environment brought about by the reform does not have an effect on their behaviour. The very purpose of the reform is to influence the behaviour of taxpayers, in order to encourage them to increase their income. Such dynamic effects will be analysed in a more comprehensive fashion in sections 6.3 and 6.4 with the help of economic indicators.

Because of its vast scope, the proposed reform will affect the tax burden of all taxpayers. Some measures may come into effect during the initial implementation phase of the reform, while others may take a few years before they are finally implemented. Whereas the changes to the tax system proposed by the various options would be part of the initial implementation, certain changes to the transfer system would be introduced gradually.

First, the reform's effects on middle-income earners, who are the most numerous, will be discussed. In 1983, about 45% of all households have income from private sources of between $15 000 and $50 000 per year; about 50% of taxpayers earn less, and about 5%, more, than those in this bracket. Any reform which significantly affects the behaviour of middle-income households will have considerable repercussions on Québec's economy generally. Second, the reform's effects on low-income households will be assessed, with particular emphasis on changes in their disposable income, and the extent to which they are encouraged to work. To conclude, the case of high-income households will be examined, with particular emphasis on the competitive nature of Québec's tax system as it concerns them.

6.1.1 Middle-income taxpayers

Table VI.1 illustrates the impact of the reform on the most representative types of household, that is, a couple with two children, either between 6 and 11 or under 6, where only one spouse works outside the home. It also indicates the effects of the reform on three other typical households: a childless couple, and a single person, according to whether he lives alone in separate dwelling, or shares housing. Tables VI.2, VI.3 and VI.4 deal with the fiscal situation of households in which both spouses work and those consisting of persons 65 and over. The criteria used to assess the impact of the reform are their net contribution to government financing (taxes, contributions to health insurance, to the Québec Pension Plan, consumption taxes and property taxes net of all transfers and tax credits) and implicit marginal tax rates (proportion of an increase in employment income allocated to taxes, child care expenses and transfer reductions).

6.1.1.1 Couples with children

As can be seen from Table VI.1, the net contribution to government financing of a couple with children will decrease under the reform, while its disposable income will increase. Moreover, under almost every option, its implicit marginal tax rate will also fall, thereby making it more advantageous to work.

The net reduction in income tax varies between $530 and $1 370 when the children are between 6 and 11, according to income and the option under consideration, and between $330 and $1 180 when they are under 6. These tax reductions are due, in the first place, to the new lump-sum tax reduction intended to raise the zero tax threshold, which will come to between $410 and $1 530 (under option III) for these two types of household. They are due, secondly, to higher exemptions for dependent children. Although these households would lose $211 currently paid under Québec's family allowance plan, that would be more than compensated for by new exemptions for dependent children which the breadwinner in the family would be entitled to, of $2 892 under options I and II, and $2 952 under option III. These new exemptions represent savings of between $460 and $870 in income tax, depending on whether the taxpayer is subject to the minimum or maximum marginal rate under options I and II. The $200 difference in the net contribution of these two types of household is due to the elimination of the availability allowance for children between 2 and 5.

The other aspects of the reform will only slightly affect these types of household. The basic exemption will be lower, but the spouse's exemption will be higher, with the result that the overall total will remain virtually the same: from $8 900 to $8 784 under options I and II, and to $8 964 under option III. Moreover, the tax table will not change appreciably except under option III, where the reductions in marginal tax rates will be financed by an increase in the sales tax base. The increase in the general employment expense deduction will reduce the tax burden, but by less than $100. The new sales tax credit will also be of limited benefit, primarily to taxpayers earning less than $30 000, under option III. Because a portion of property taxes is integrated with personal exemptions, the new property tax credit will be less substantial than at present, since it will only affect low middle-income earners.

The impact of the reform on the marginal rates of a couple with two dependent children, with one spouse working outside the home, is also essentially positive, with one exception: when household income is about $20 000. This phenomenon is the result of the need to achieve a more uniform implicit marginal tax rate curve than we have at present. Moreover, it is at the level of income in question that the system will gradually recover the tax credits granted. However, the lower net contribution indicates that average tax rates are lower.

Apart from this exception, marginal rates will fall by 2% to 3% under options I and II, and by 4% to 5% under option III. It would have been hard to do more, given the expected availability of funds, and the considerable number of taxpayers affected in this income bracket. Nonetheless, section 6.3 shows that the economic impact will be considerable.

6.1.1.2 Other household categories

The reductions granted are slightly less substantial among the other categories of middle-income taxpayers. However, the same trends are to be noted, that is, that option III is of greater benefit to middle-income households and more especially to high middle-income families (earning more than $30 000), and that the other options confer similar but lower benefits on all categories of taxpayers.

On the one hand, childless couples derive less benefit from the reform than those with children, as they do not benefit from the more complete coverage of the basic needs of children. The same applies to single people living alone in separate dwellings. On the other hand, single people sharing housing with others benefit the most from the reform, as they are no longer seen to have the same basic needs as single people living alone in a separate dwelling.

The tax situation of couples with both spouses working is given in Tables VI.2 and VI.3. Table VI.2 shows the variation in their net contribution to government financing for spouses who earn the same amount, varying between $25 000 and $60 000; Table VI.3 indicates their marginal tax rates.

The typical household shown in Table VI.2 is that of a couple with two children between 6 and 11. It can therefore be compared with the second case in Table VI.1. As can be seen, under the reform the differential in net contribution to government financing between families in which only one spouse works and families with both spouses working is reduced. For example, for an income of $40 000 under option II, the net contribution is reduced by $826 in the first case, and by $524 in the second, thus reducing the differential in the net contribution at this income level by about $300. This arises from the fact that higher personal exemptions are no longer granted to couples with both spouses working and the progressive nature of the table of marginal income tax rates is less marked. It follows that the tax reductions granted them are less than those granted to couples with only one income.

It is also of interest to note how the reform would change the implicit marginal tax rates for the second spouse entering the labour market. Table VI.3 shows this result for different family situations, including the couple which, under the present system, receives a grant for child care costs, and the couple that does not.

Table VI.1

Difference in net contribution and implicit marginal tax rates between the present system and reform options for various types of household, according to employment income
(in dollars)

Type of household	Income: 15 000 $		Income: 18 000 $		Income: 21 500 $	
	Net contribution[1]	**Marginal rate (%)**	**Net contribution**[1]	**Marginal rate (%)**	**Net contribution**[1]	**Marginal rate (%)**
Couple 2 children under 6 One spouse earns employment income						
• Option I	−353	−9	−376	+3	−331	—
• Option II	−436	−13	−494	+3	−420	+1
• Option III	−460	−15	−562	—	−532	+1
Couple 2 children between 6 and 11 One spouse earns employment income						
• Option I	−548	−9	−573	+2	−530	—
• Option II	−632	−13	−691	+3	−619	+1
• Option III	−661	−16	−765	—	−719	+1
Couple No children One spouse earns employment income						
• Option I	−244	+5	−179	+1	−161	—
• Option II	−365	+5	−270	+1	−234	+1
• Option III	−445	+2	−369	+1	−293	+2
Single person living alone						
• Option I	−133	—	−152	−1	−163	—
• Option II	−232	—	−225	—	−218	+1
• Option III	−237	−2	−303	−3	−366	−2
Single person sharing a housing unit						
• Option I	+2	+1	+28	—	+35	—
• Option II	−32	+2	+10	+1	+36	+1
• Option III	−86	−1	−103	−2	−162	−2

1. A sign (−) sign indicates a reduction in the net contribution (or tax burden) in relation to the present system, as a result of the reform.
2. One one of the children is under 2 and the other is between 2 and 5.

Table VI.1 (continued)

Difference in net contribution and implicit marginal tax rates between the present system and reform options for various types of household, according to employment income
(in dollars)

Income: 25 000 $		**Income: 30 000 $**		**Income: 40 000 $**		**Income: 50 000 $**	
Net contribution	**Marginal rate (%)**	**Net contribution**	**Marginal rate (%)**	**Net contribution**	**Marginal rate (%)**	**Net contribution**	**Marginal rate (%)**
−360	−3	−486	−2	−641	−3	−832	−2
−436	−2	−509	−2	−616	−2	−769	−2
−481	−1	−560	−5	−844	−5	−1 176	−4
−567	−2	−691	−2	−851	−3	−1 015	−2
−622	−1	−713	−2	−826	−2	−953	−2
−691	−1	−742	−1	−1 060	−5	−1 365	−4
−189	−1	−276	−2	−400	−1	−528	−2
−233	—	−296	−1	−366	−1	−465	−2
−326	−3	−475	−4	−730	−3	−1 003	−4
−177	—	−207	—	−309	−2	−473	−2
−208	—	−211	—	−277	−1	−407	−1
−433	−2	−541	−2	−802	−4	−1 138	−4
+28	—	+5	—	−91	−2	−246	−2
+48	—	+52	—	—	−1	−122	−1
−223	−2	−305	−2	−568	−4	−895	−4

The new tax and transfer systems are clearly more advantageous for the couple which does not receive an allowance for child care costs at present since under it all types of child care would be subsidized. In all the situations studied, there is a greater incentive to work under option III than under the present system. In fact, the second spouse always benefits more by working. Under option II there is almost always a greater incentive to work. On the other hand, when the first spouse earns the minimum wage, the conditions of option I are less of an incentive for households who have only one child and for those who have two children between 6 and 11. In a general way, however, the new tax and transfer system will provide more incentive to work for the second spouse entering the labour market.

As Table VI.4 shows, the elderly are little affected by the reform. The tax reductions they would receive are smaller than for other taxpayers. In certain cases, mainly involving couples, their taxes may even be raised. This can be explained by the fact that the reform tends to concentrate on those who are the hardest hit by the present system. In addition, it must be remembered that elderly persons who continue to work after the age of 65 will be subject to the same tax and transfer systems as those under 65.

In general then, middle-income taxpayers, mainly families with children, would benefit from the reform, because their tax burden would be lightened and their implicit marginal tax rates reduced.

6.1.2 Low-income taxpayers

Because of the guarantee that the existing level of social aid benefits will not be reduced for those receiving ordinary benefits, and because of the introduction of new programs to further integration into the labour market, it is harder to analyse the effects of the reform with respect to low-income households. The new income guarantee benefits for those able to work are determined not only by the non-availability benefits related to their recognized essential needs and those of the other members of the household, but also by the number of hours they devote to reintegration activities or active employment, and (under options II and III) their willingness — or lack of it — to take the necessary steps to find employment. In addition, the reform of the transfer system will be fully implemented over several years.

Diagrams VI.1 to VI.3 trace the growth in the disposable income of single persons between 30 and 64 who live alone, and of two-parent families with two children between 6 and 11, with only one employment income, under all three options. The situations of a person working full-time at the minimum wage, a person in vocational training or participating in community activities, a person who is available (ordinary benefit), and a person who is not available (non-availability benefit), are examined. These diagrams were constructed on the assumption of 5% annual inflation, and a constant minimum wage of $4.00 an hour.

Table VI.2

Impact of different options on net contribution to government financing
Couple with two children between 6 and 11
Two equal employment incomes
(in dollars)

Employment income	**Net contribution under present system**	**Variation in net contribution according to options**		
		Option I	**Option II**	**Option III**
25 000	3 733	−523	−619	−468
30 000	5 917	−503	−611	−547
40 000	10 656	−470	−524	−670
50 000	15 109	−488	−487	−828
60 000	19 815	−557	−500	−1 044

Under options II and III, beneficiaries who are available to search for employment or to participate in a reintegration activity would be guaranteed the same level of benefits as under the existing system while, as part of the reform's initial implementation phase, beneficiaries who are not active would have their benefits reduced to the level of their short-term essential needs as soon as they refuse to participate in a reintegration activity offered to them or declined a job which they could have filled. Non-availability benefits would be indexed to the cost of living while ordinary benefits would be frozen until they were equal to the consumption expenditures of low-income households in satisfaction of their short-term essential and clothing needs; they would then also be indexed to the cost of living.

As a result, in the reform's initial implementation phase, the couple with two children between 6 and 11 and with one of the spouses available would, under option II, have $10 466 of disposable income. Since this is higher than the consumption expenditures required to satisfy this household's short-term essential needs plus clothing, its income guarantee program benefits would remain unchanged the following year. For the second year, since the cost of purchases necessary to satisfy short-term essential needs plus clothing will have increased, because of inflation, to $10 680, the household's ordinary benefits will increase so as to produce a disposable income of $10 680. Ordinary benefits would subsequently be indexed to the inflation rate to match the progression in the cost of living. Moreover, it should be noted that the household's disposable income will increase each year if one of the spouses works at the minimum wage, even if it does not change because the non-availability benefit is indexed to the cost of living.

Under option I, the situation is different. Since there is no distinction between persons who are available and those who are not, all beneficiaries would be guaranteed, in the reform's initial implementation phase, benefits at least equal to what they are receiving under the existing system. The ordinary benefits of persons protected by the guarantee would be frozen or partially indexed until they were equal to the consumption expenditures of low-income households for the satisfaction of their short and long-term essential needs.

For example, under option I, single persons between 30 and 64 who are not active and live alone would be guaranteed, in the reform's initial implementation phase, their current disposable income, that is $4 392. As this exceeds the level of expenditures required to satisfy their short and long-term essential needs, their benefits would not change the following year. They would be increased in the second year to provide a disposable income sufficient to satisfy their short and long-term essential needs, that is, $5 114. Subsequently, their benefits would keep pace with inflation, so that their disposable income would always equal the amount of expenditures necessary to satisfy their short and long-term essential needs.

Unless otherwise indicated, this chapter describes the effects of the reform, when it is fully implemented, in 1983 dollars. Under all three options, there is no difference, for persons who earn employment income or who participate in a reintegration activity, between their situation in the reform's initial implementation phase and when it is fully in effect. This means that in both cases, their disposable income, net contribution and implicit marginal tax rates are the same. The distinction between the reform's effects during its initial implementation phase, and its effects when it is fully implemented is significant only for persons who are not active.

Moreover, the proposed reform is designed to encourage those able to work who are temporarily unemployed to remain active during this period, insofar as is possible, in order to increase their chances of being hired. The effect of the reform on such taxpayers cannot be assessed without taking into account this increased incentive to earn income of one's own.

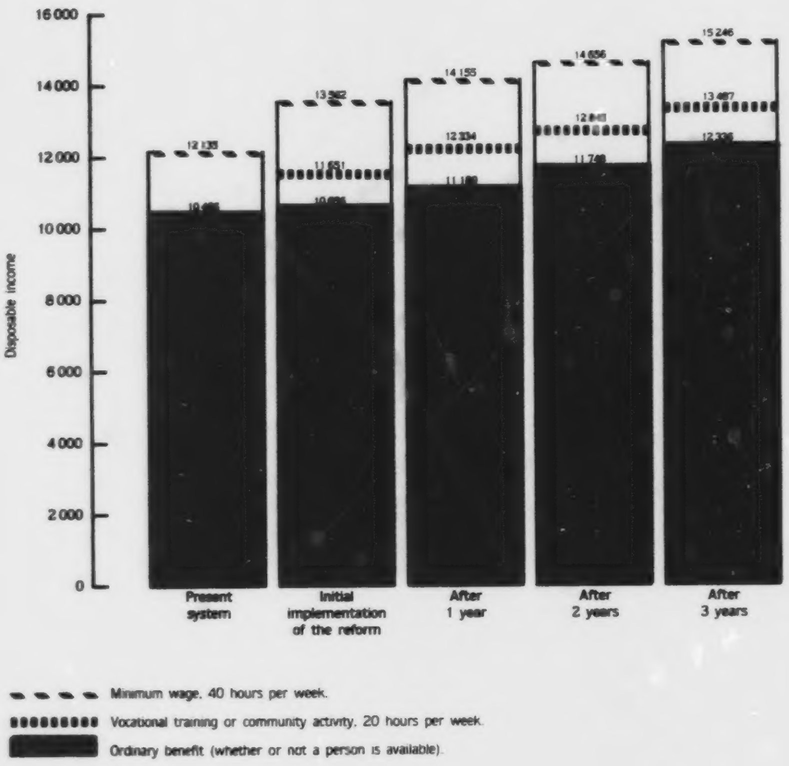
The impact of the reform on low-income taxpayers will be analysed using six diagrams which correspond to each of the five typical households employed in the preceding section, in addition to the case of individuals under 30.

Diagram VI.4	Couples with two children between 6 and 11;
Diagram VI.5	Couples with two children under 12;
Diagram VI.6	Childless couples;
Diagram VI.7	Single persons between 30 and 64 living alone in separate dwellings, without dependents;
Diagram VI.8	Single persons between 30 and 64 sharing housing, without dependents;
Diagram VI.9	Single persons under 30 living alone in separate dwellings, without dependents.

Diagram VI.1

Couple with 2 children between 6 and 11, and only one employment income

Growth in disposable income[1].
Under option I, from initial to full implementation of the reform.
(in dollars based on 1983 benefits).

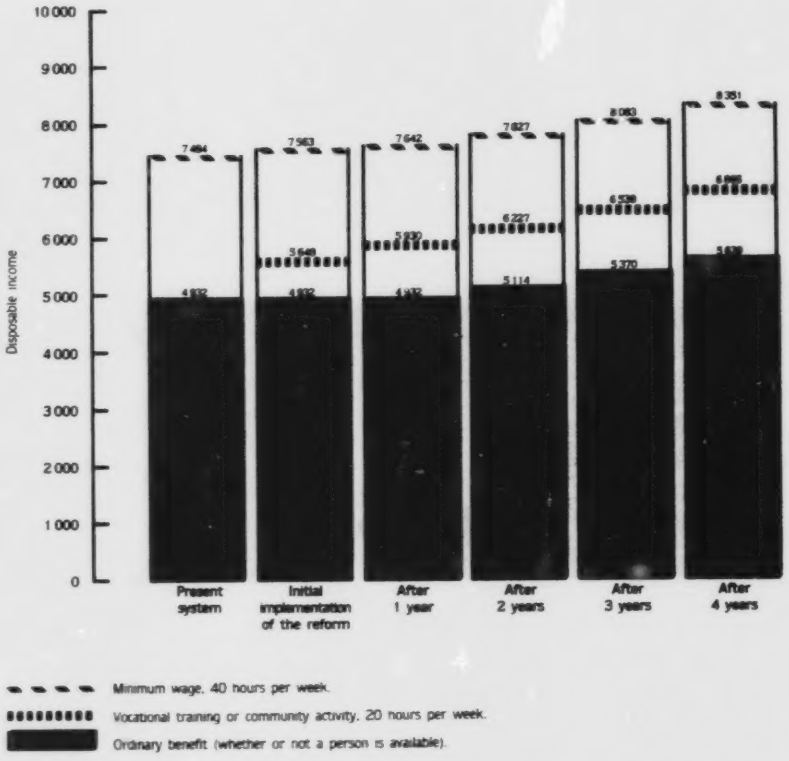


1. Assuming transfers are indexed at 5% annually, and that the income tax structure is fully indexed.

Diagram VI.1 (continued)

Single person, 30-64, without dependents, living alone in a separate dwelling

Growth in disposable income[1].
Under option I, from initial to full implementation of the reform.
(in dollars based on 1983 benefits).

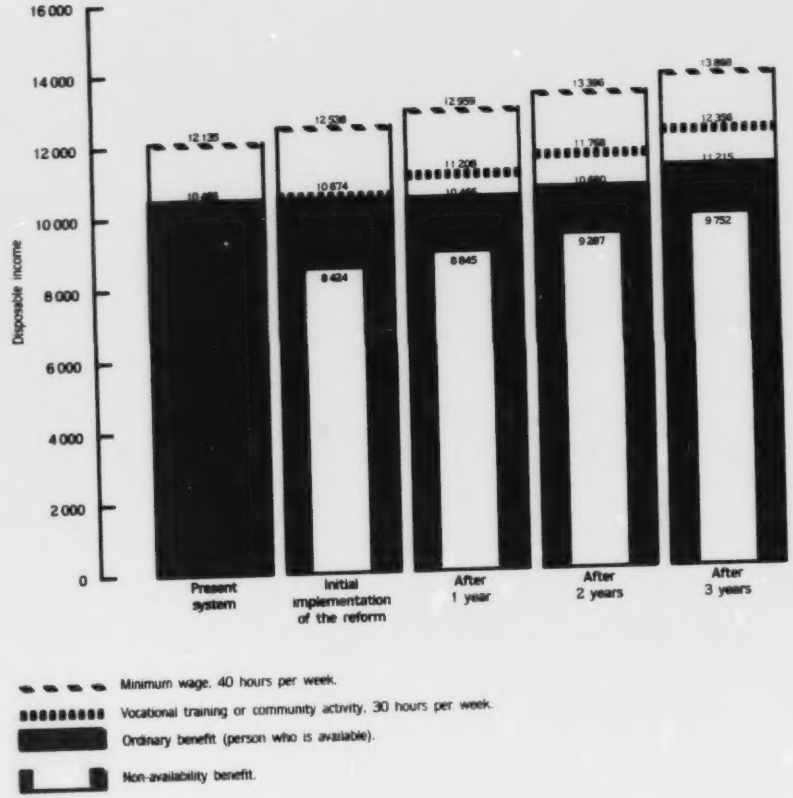


1. Assuming transfers are indexed at 5%, and that the income tax structure is fully indexed.

Diagram VI.2

Couple with 2 children between 6 and 11, and only one employment income

Growth in disposable income[1].
Under option II, from initial to full implementation of the reform.
(in dollars based on 1983 benefits).

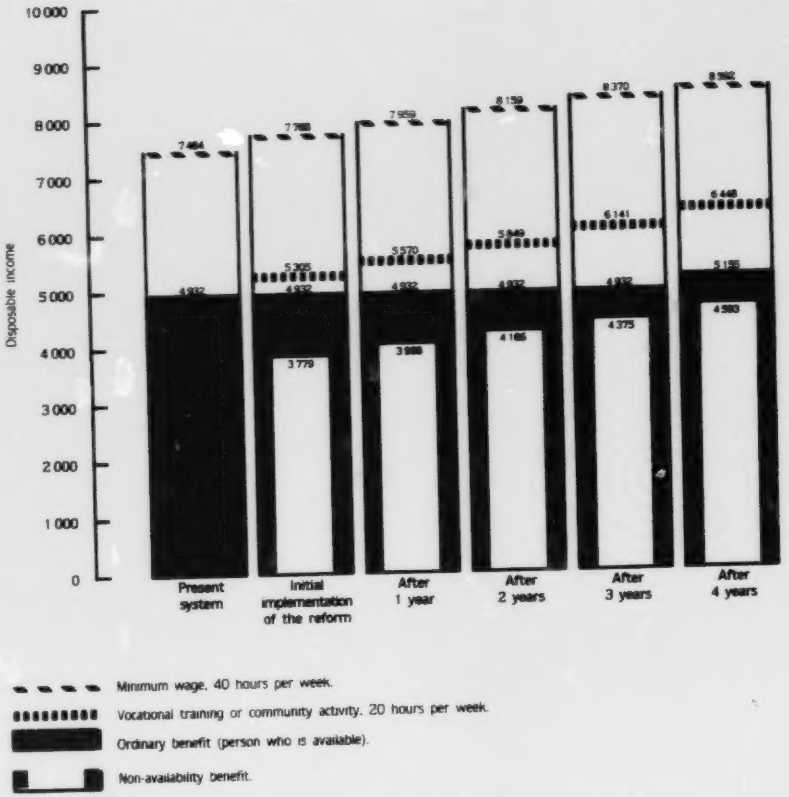


1. Assuming transfers are indexed at 5% annually, and that the income tax structure is fully indexed.

Diagram VI.2 (continued)

Single person, 30-64, without dependents, living alone in a separate dwelling

Growth in disposable income[1].
Under option II, from initial to full implementation of the reform.
(in dollars based on 1983 benefits).

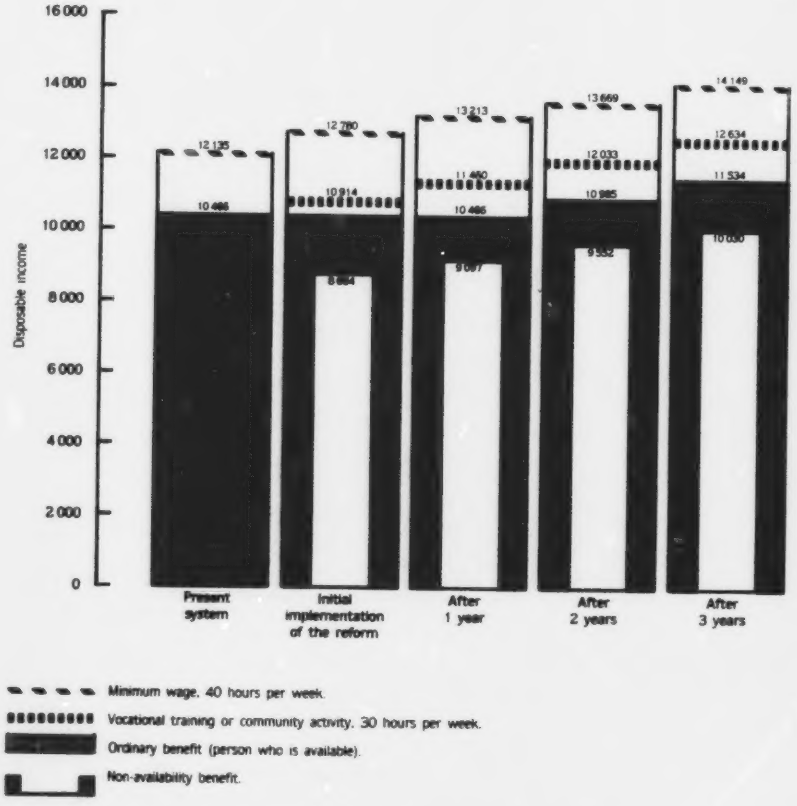


1. Assuming transfers are indexed at 5% annually, and that the income tax structure is fully indexed.

Diagram VI.3

Couple with 2 children between 6 and 11, and only one employment income

Growth in disposable income[1].
Under option III, from initial to full implementation of the reform.
(in dollars based on 1983 benefits).

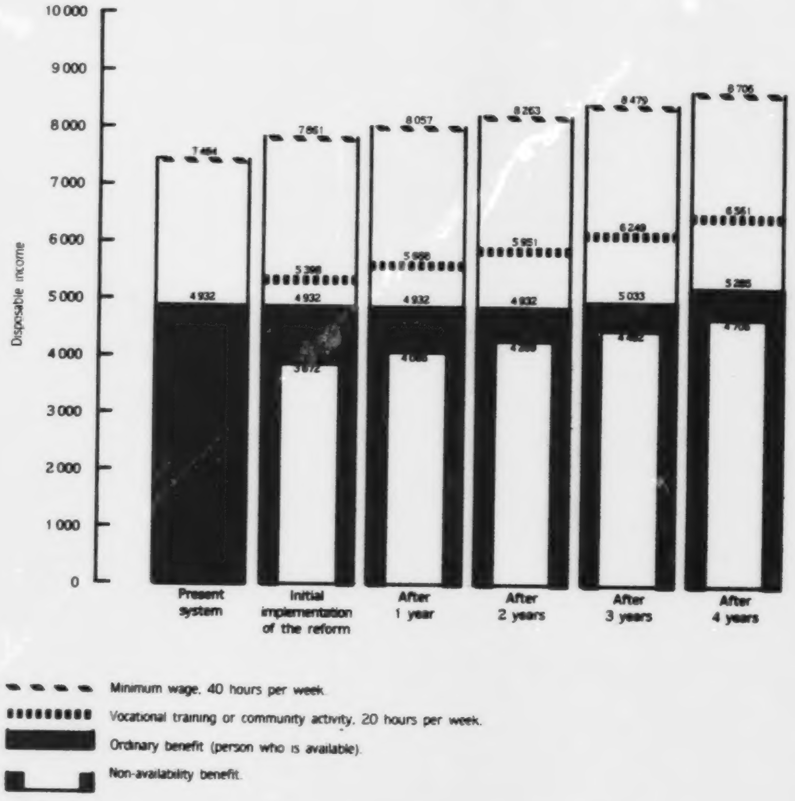


1. Assuming transfers are indexed at 5% annually, and that the income tax structure is fully indexed.

Diagram VI.3 (continued)

Single person 30-64, without dependents, living in a separate dwelling

Growth in disposable income[1].
Under option III, from initial to full implementation of the reform.
(in dollars based on 1983 benefits)



1. Assuming transfers are indexed at 5% annually, and that the income tax structure is fully indexed.

Table VI.3

Implicit marginal tax rate[1] upon second spouse's entry into the job market
(in percentage)

Employment income of second spouse rising	**Couple with one child between 2 and 5 Employment income of spouse already on job market**			**Couple with two children between 2 and 5 Employment income of spouse already on job market**			**Couple with 2 children between 6 and 11 Employment income of spouse already on job market**		
	8 000 $	**15 000 $**	**21 500 $**	**8 000 $**	**15 000 $**	**21 500 $**	**8 000 $**	**15 000 $**	**21 500 $**
From 0 to 8 000 $									
Increase in child care expenses in relation to increase in employment income	39	39	39	78	78	78	39	39	39
Implicit marginal tax rate[1]									
• Current system									
— without subsidies for child care	81	66	68	127	106	107	84	64	64
— with subsidies for child care	62	66	68	79	80	102	75	64	64
• Option I	83	59	61	96	87	89	83	58	60
• Option II	74	59	61	94	88	88	74	57	60
• Option III	75	60	60	94	90	89	74	58	59
From 0 to 15 000 $									
Increase in child care expenses in relation to increase in employment income	21	21	21	42	42	42	21	21	21
Implicit marginal tax rate[1]									
• Current system									
— without subsidies for child care	60	51	53	84	69	71	61	48	50
— with subsidies for child care	60	51	53	70	65	71	61	48	50
• Option I	63	49	51	80	64	66	65	48	51
• Option II	57	49	51	73	64	66	57	48	51
• Option III	58	48	49	75	64	65	58	48	50

1. The implicit marginal tax rate corresponds to the increase in taxes, the reduction in transfers and the increase in child care expenses relative to the increase in employment income.

Table VI.3 (continued)

Implicit marginal tax rate[1] upon second spouse's entry into the job market
(in percentage)

Employment income of second spouse rising	Couple with one child between 2 and 5 Employment income of spouse already on job market			Couple with two children between 2 and 5 Employment income of spouse already on job market			Couple with 2 children between 6 and 11 Employment income of spouse already on job market		
	8 000 $	**15 000 $**	**21 500 $**	**8 000 $**	**15 000 $**	**21 500 $**	**8 000 $**	**15 000 $**	**21 500 $**
From 0 to 21 500 $									
Increase in child care expenses in relation to increase in employment income	15	15	15	29	29	29	15	15	15
Implicit marginal tax rate[1]									
• Current system									
— without subsidies for child care	54	49	49	71	62	62	55	47	48
— with subsidies for child care	54	49	49	69	62	62	55	47	48
• Option I	56	47	48	68	58	60	57	47	49
• Option II	52	47	48	63	57	60	52	47	49
• Option III	52	46	46	63	57	58	52	47	47

[1] The implicit marginal tax rate corresponds to the increase in taxes, the reduction in transfers and the increase in child care expenses relative to the increase in employment income.

Each diagram is divided into four parts: part A, which deals with persons benefiting under the income guarantee program, compares the essential short and long-term needs and other important but nonessential needs of the household considered with its disposable income under the current tax system and following the initial implementation of the reform under each of the options being considered and according to various hypotheses respecting availability and participation in reintegration activities (community work, vocational training), and with disposable income from work at the minimum wage, for 40 hours per week.

Part B, which deals with households having employment income, illustrates and compares, by income bracket, the effect of the current tax and transfer systems and each of the options under study on the household's net contribution to government financing or, stated differently, on total taxes and contributions to the QPP and unemployment insurance (less credits and transfers to be received) which the household will have to pay. This table makes it possible to determine how each of the options will affect the tax burden of the household for a given income. These data are equally valid for the initial and final implementation of the reform.

Part C of the diagrams highlights the manner in which **net hourly wages** will be modified when the wage earner goes from a situation in which he earns no employment income to that where he works full time for the minimum wage ($4.00 an hour), the average industrial wage ($10.75 an hour), or an intermediate wage ($7.50 an hour). This part of the diagram will be regarded as the average net hourly wage derived from entering the labour market. Once again, these data are valid for both the initial and final implementation of the reform. Such is also the case for part D of the diagram which illustrates and compares, for the current system and each of the options proposed, the implicit marginal tax rates under Québec's tax and transfer system, at various levels of income.

Table VI.4

Comparison of net contribution
Households consisting of persons 65 and over where the head of the household is retired
(in dollars)

Household income			**Net contribution under the current system**[3]	**Change in net contribution:**[3] **Options — current system**		
Pension and investments[1]	**OAS and QPP**[2]	**Total**		**Option I**	**Option II**	**Option III**
Couple 65 and over						
0	12 962	12 962	959	53	53	64
5 000	10 466	15 466	1 089	37	35	80
10 000	10 274	20 274	2 232	−2	−124	−89
15 000	10 274	25 274	4 187	130	52	76
20 000	10 274	30 274	6 299	133	91	88
25 000	10 274	35 274	8 598	70	54	−48
30 000	10 274	40 274	11 029	29	34	−123
40 000	10 274	50 274	16 150	−56	2	−351
Single person 65 and over						
0	8 224	8 224	725	23	23	52
5 000	7 208	12 208	1 634	−168	−303	−241
10 000	7 208	17 208	3 561	−103	−203	−151
15 000	7 208	22 208	5 629	−56	−130	−175
20 000	7 208	27 208	7 900	−94	−125	−259
25 000	7 208	32 208	10 306	−146	−150	−405
30 000	7 208	37 208	12 740	−191	−168	−519
40 000	7 208	47 208	18 010	−313	−257	−769

1. Pension income is equal to investment income.
2. The Old Age Security (OAS) pension is 3 066 $ per spouse and benefits from the Québec Pension Plan are 4 142 $ for the head of the household, assuming that he earned the equivalent of the average industrial wage during his working years. The amount exceeding 10 274 $ per couple and 7 208 $ per single person corresponds to the amount of the Guaranteed Income Supplement.
3. The net contribution includes the total of federal and Québec income taxes, consumption taxes and property taxes reduced by tax credits.

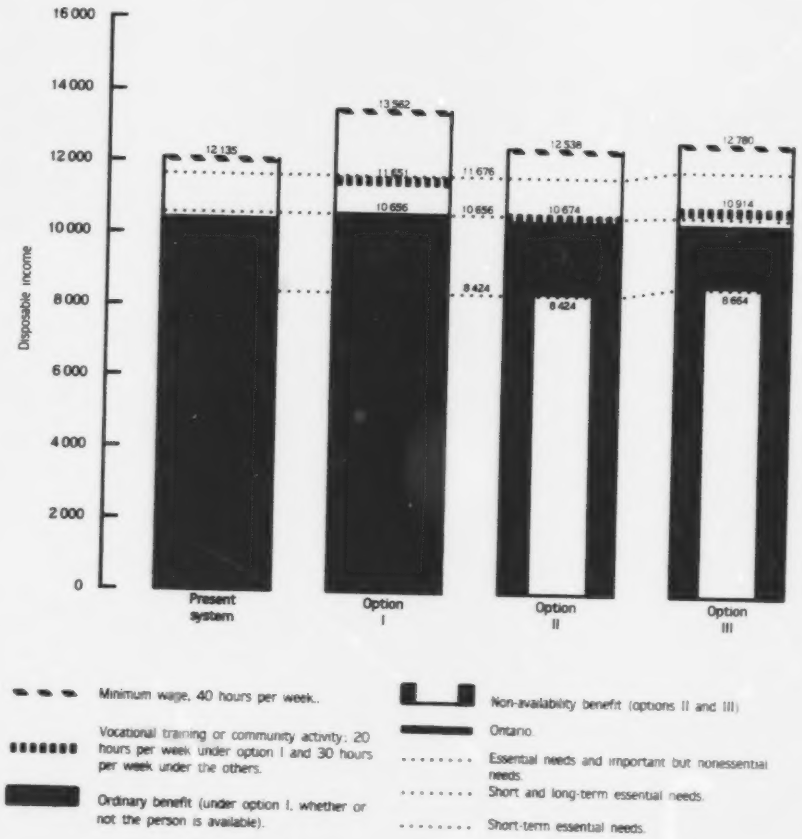
6.1.2.1 Couples with two children under 12

Diagram VI.4 examines the situation of a couple with two children between 6 and 11. Part A gives the following information: option I, under which basic benefits would be high, raises the benefits of a recipient couple without employment income by $190 a year whether it is available or not. But under options II and III these same benefits for those who are not available to take part in reintegration activities would be reduced to the level of short-term basic needs, an annual drop of $2 042 under option II and $1 802 under option III, while providing to those who are available the same income as the existing social aid program. Participation by recipients in reintegration activities would give them a higher income than under the present system and would encourage them, under options II and III in particular, to improve their chances of finding work and hence speed up their return to the labour market. For example, the participation of one of the spouses in an occupational training program for 30 hours a week over 50 weeks increases disposable income by $2 250 a

Diagram VI.4

Couple with two children between 6 and 11, and only one employment income[1]

A. Comparison of disposable income. Following the implementation of the reform
(in dollars based on 1983 benefits).



B: Impact of the various proposals on the net contribution to government expenditures[2]
(in dollars)

Employment income of household	Net contribution Present system	Option I	Option II	Option III
8 000	- 2 989	- 4 287	- 3 356	- 3 433
10 000	- 1 812	- 2 964	- 2 313	- 2 373
12 000	- 737	- 1 667	- 1 306	- 1 349
15 000	1 361	813	730	700

Employment income of household	Change in net contribution Option — Present system Option I	Option II	Option III
8 000	- 1 298	- 367	- 444
10 000	- 1 152	- 501	- 561
12 000	- 931	- 570	- 612
15 000	- 548	- 632	- 661

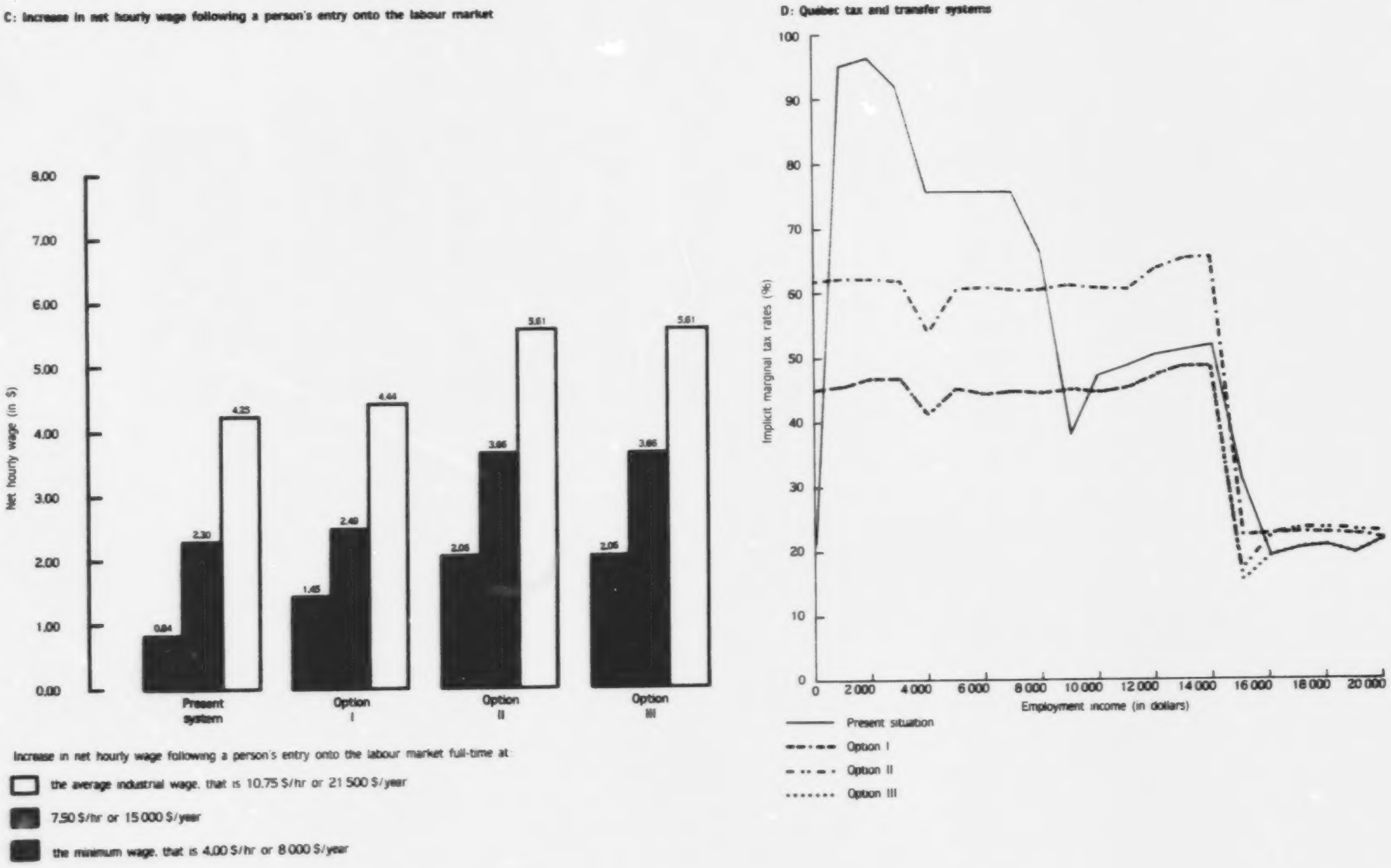
---

[1] When one of the children is between 2 and 5, an amount of 300 $ must be added to the before tax income under the present system to take account of the availability allowance. If both children are between 2 and 5, the adjustment is 500 $.

[2] When one of the children is between 2 and 5, the net contribution under the present system must be reduced by 300 $ to take into account the availability allowance. The reduction is 500 $ if both children are between 2 and 5. A corresponding adjustment must also be made to the changes in net contribution compared with the present system.

Diagram VI.4 (continued)

Couple with two children between 6 and 11, and only one employment income[1]



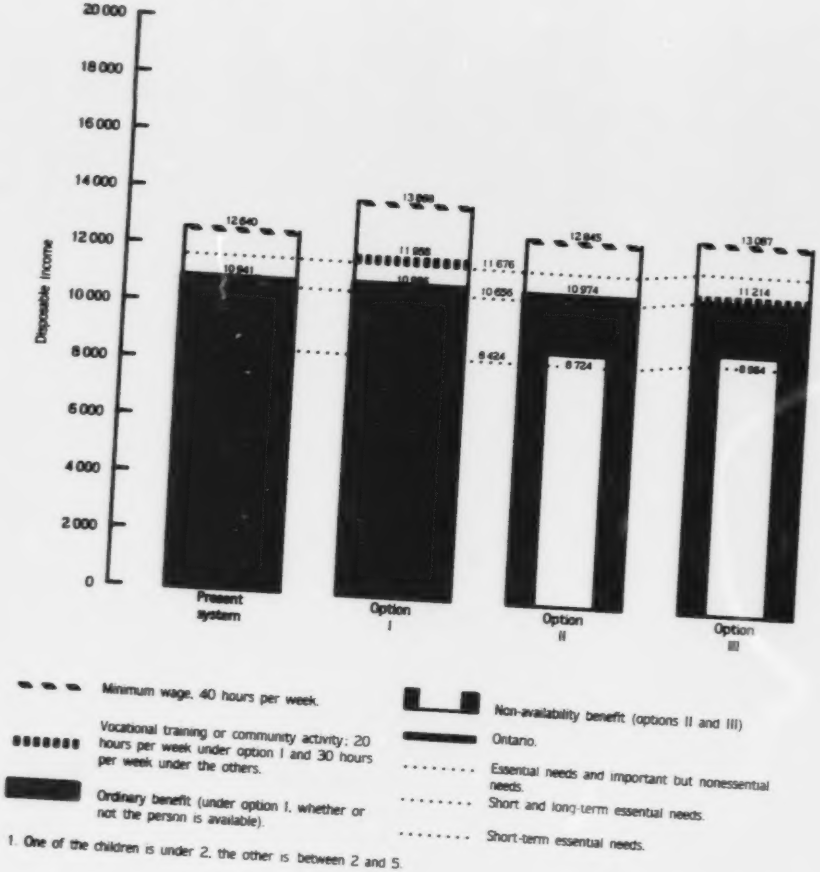
C: Increase in net hourly wage following a person's entry onto the labour market

D: Quebec tax and transfer systems

Diagram VI.5

Couple with two children under 6 and only one employment income[1]

A. Comparison of disposable income. Following the implementation of the reform.
(in dollars based on 1983 benefits).



[1] One of the children is under 2, the other is between 2 and 5.

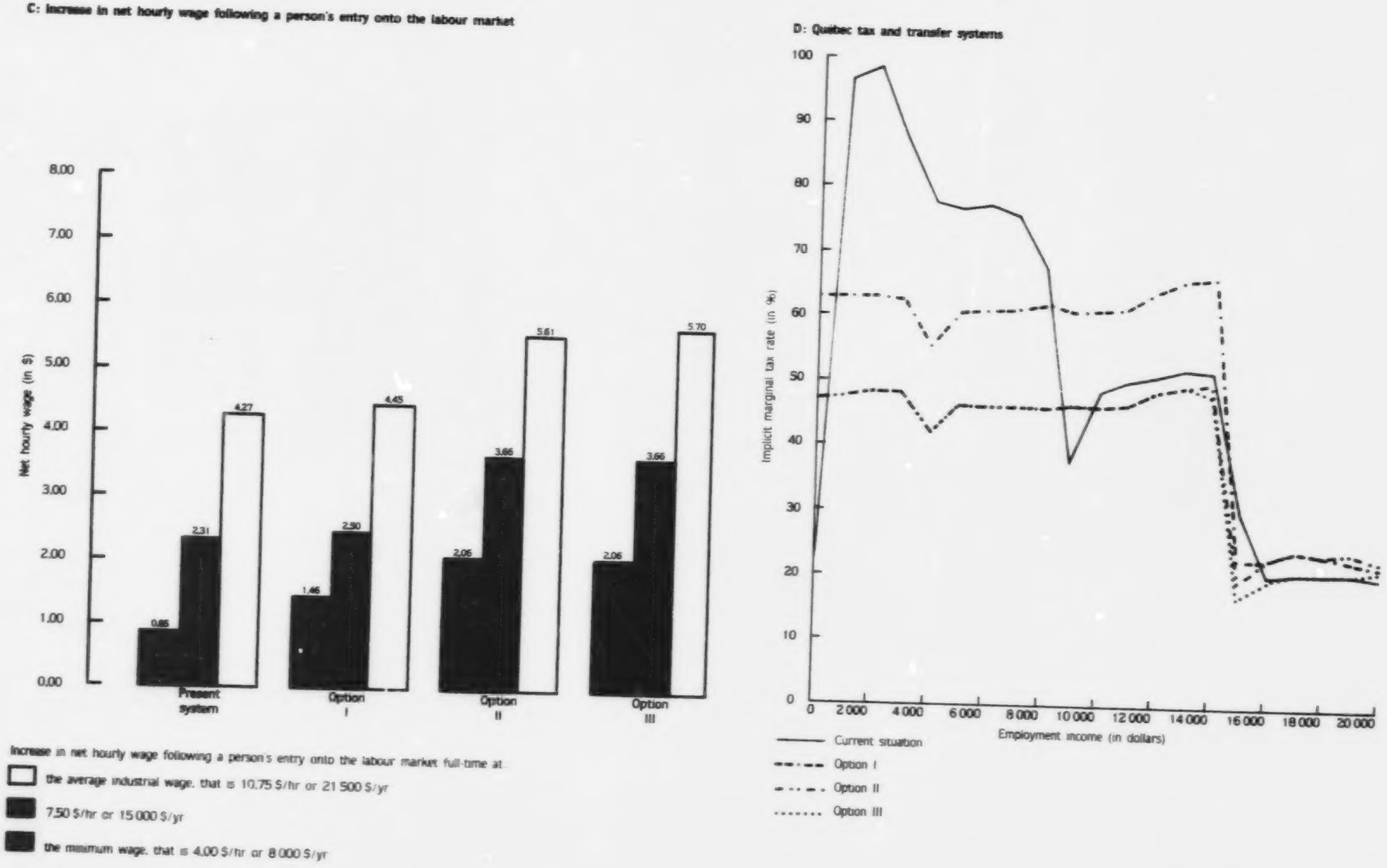
B: Impact of the various proposals on the net contribution to government expenditures
(in dollars)

Household employment income	Net contribution			
	Current system	Option I	Option II	Option III
8 000	-3 453	-4 562	-3 631	-3 703
10 000	-2 275	-3 239	-2 588	-2 643
12 000	-1 206	-1 954	-1 582	-1 619
15 000	890	537	454	430

Household employment income	Change in net contribution Option — Current system		
	Option I	Option II	Option III
8 000	-1 109	-178	-250
10 000	-964	-313	-368
12 000	-748	-376	-413
15 000	-353	-436	-460

Diagram VI.5 (continued)

Couple with two children under 6 and only one employment income[1]

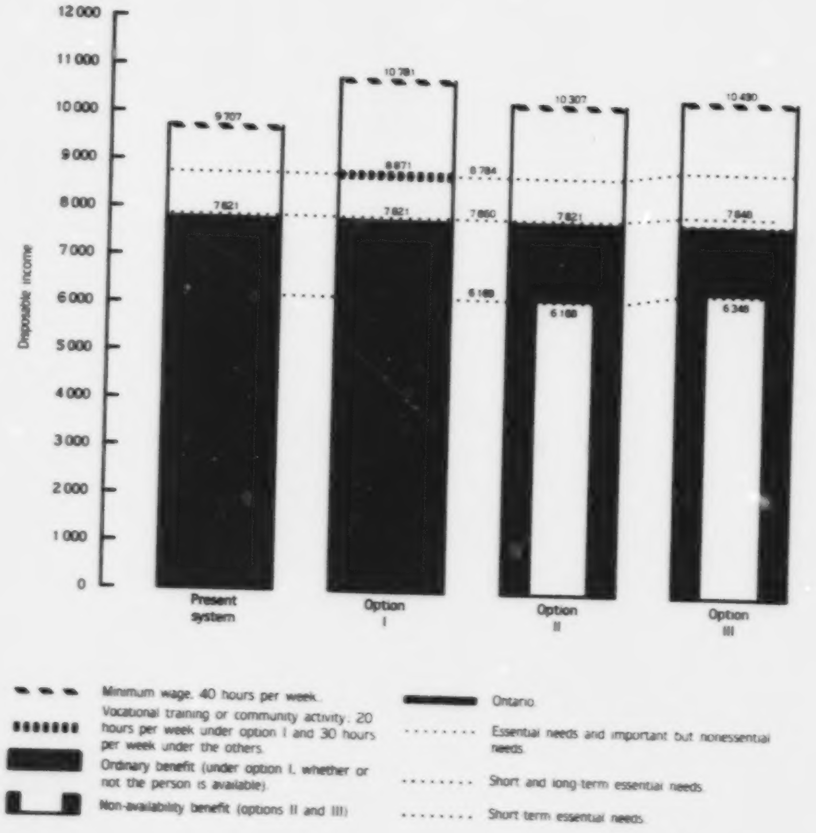

C: Increase in net hourly wage following a person's entry onto the labour market

D: Québec tax and transfer systems

Diagram VI.6

Childless couple with only one employment income

A. Comparison of disposable income. Following the implementation of the reform
(in dollars based on 1983 benefits).



B: Impact of the various proposals on the net contribution to government expenditures
(in dollars)

Employment income of household	Present system	Net contribution Option I	Net contribution Option II	Net contribution Option III
8 000	−785	−1 758	−1 330	−1 411
10 000	75	−454	−308	−374
12 000	1 250	948	801	749
15 000	2 877	2 633	2 512	2 432

Employment income of household	Change in net contribution Option — Present system Option I	Option II	Option III
8 000	−973	−545	−626
10 000	−529	−383	−449
12 000	−302	−448	−501
15 000	−244	−365	−445

Diagram VI.6 (continued)

Childless couple with only one employment income

C: Increase in net hourly wage following a person's entry onto the labour market

D: Quebec tax and transfer systems

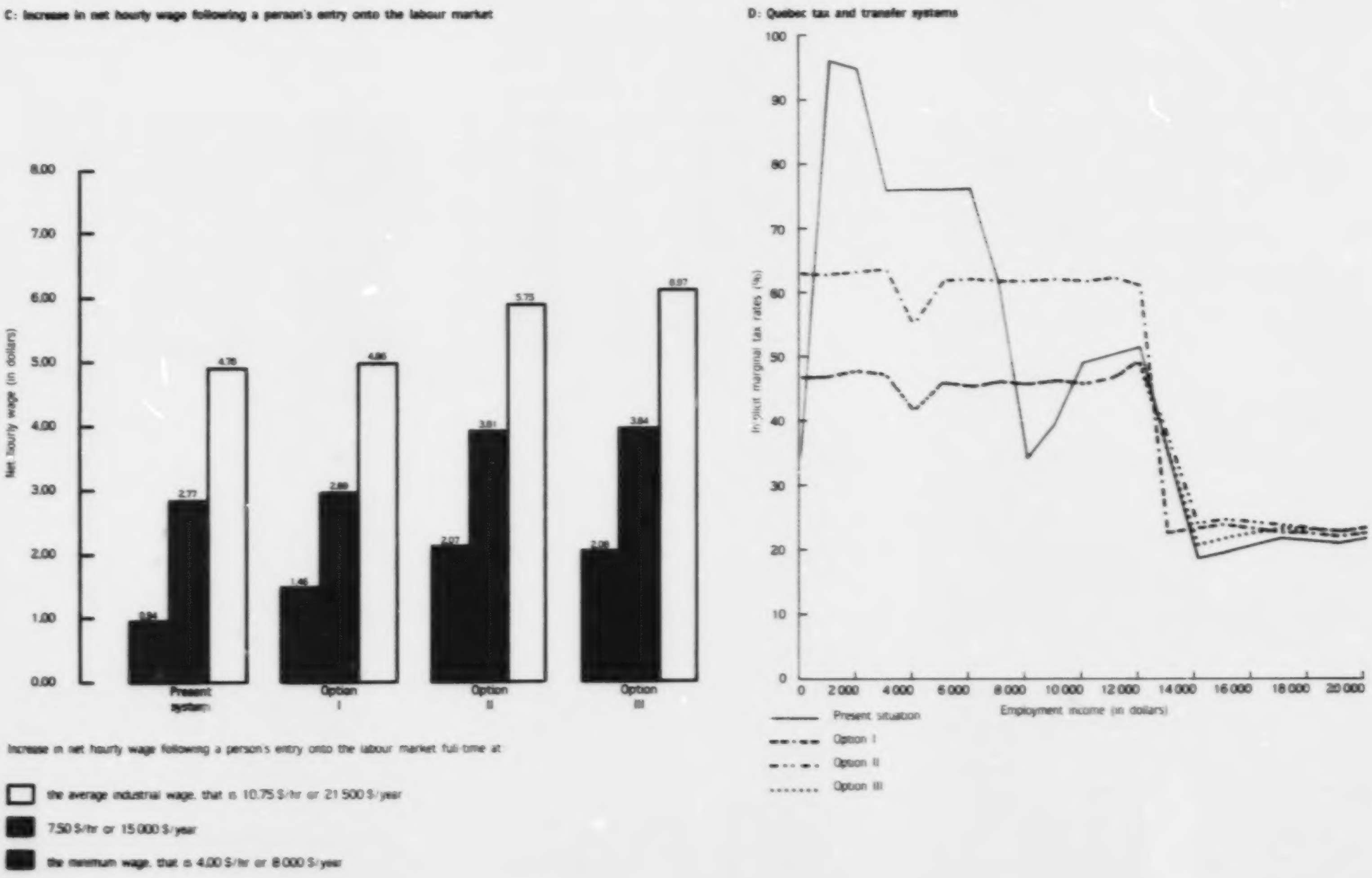
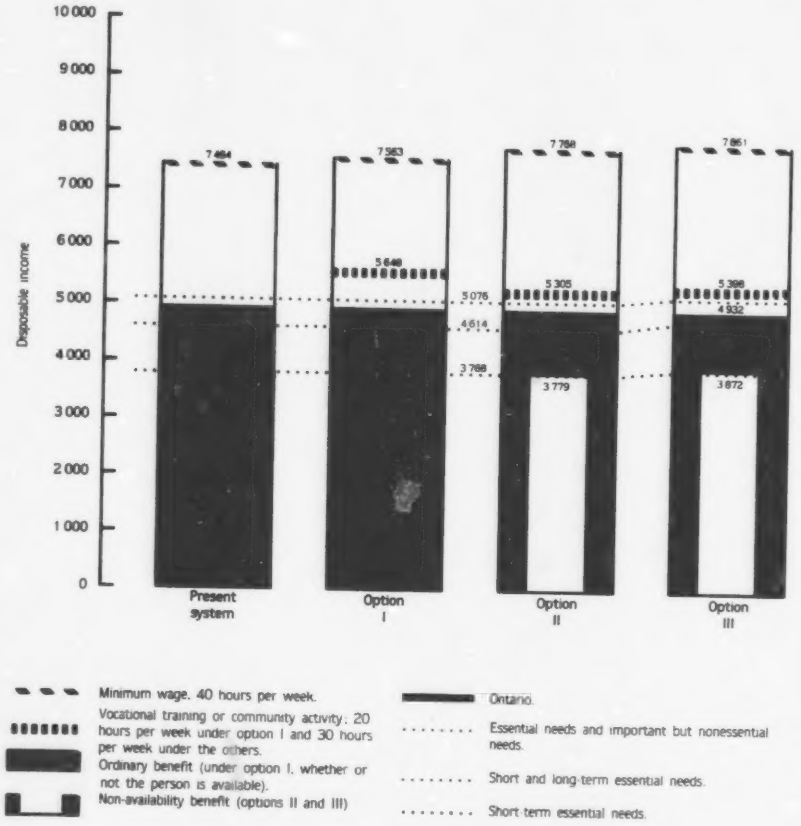


Diagram VI.7

Single person between 30 and 64, without dependents, living alone in a separate dwelling

A. Comparison of disposable income. Following the implementation of the reform
(in dollars based on 1983 benefits).



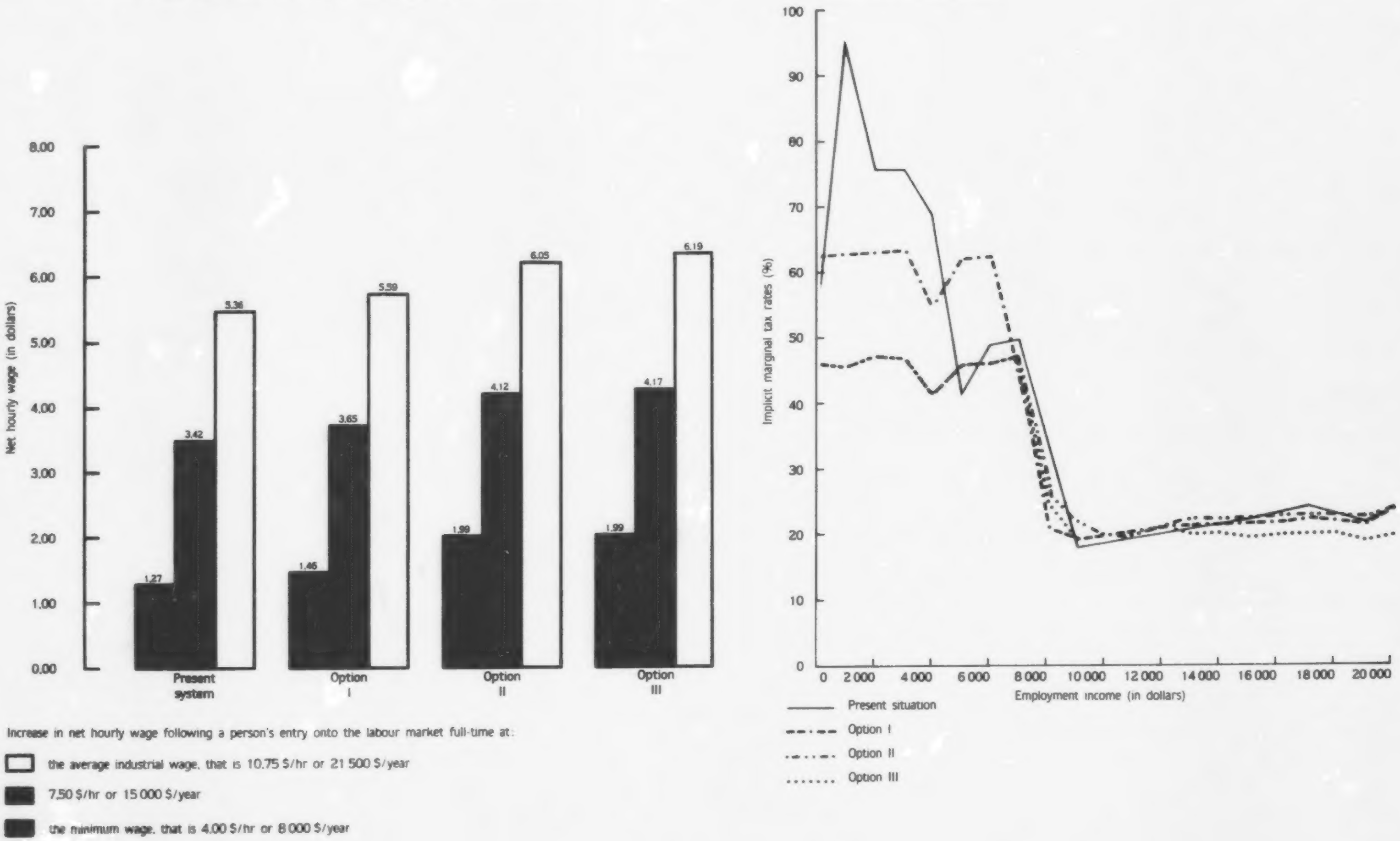
B: Impact of the various proposals on the net contribution to government expenditures
(in dollars)

Employment income of household	Present system	Net contribution		
		Option I	Option II	Option III
8 000	1 178	1 108	918	938
10 000	2 088	1 933	1 817	1 818
12 000	2 901	2 747	2 636	2 656
15 000	4 181	4 048	3 950	3 944

Employment income of household	Charge in net contribution Option — Present system		
	Option I	Option II	Option III
8 000	-70	-260	-239
10 000	-155	-271	-270
12 000	-154	-265	-244
15 000	-133	-232	-237

Diagram VI.7 (continued)

Single person between 30 and 64, without dependents, living alone in a separate dwelling



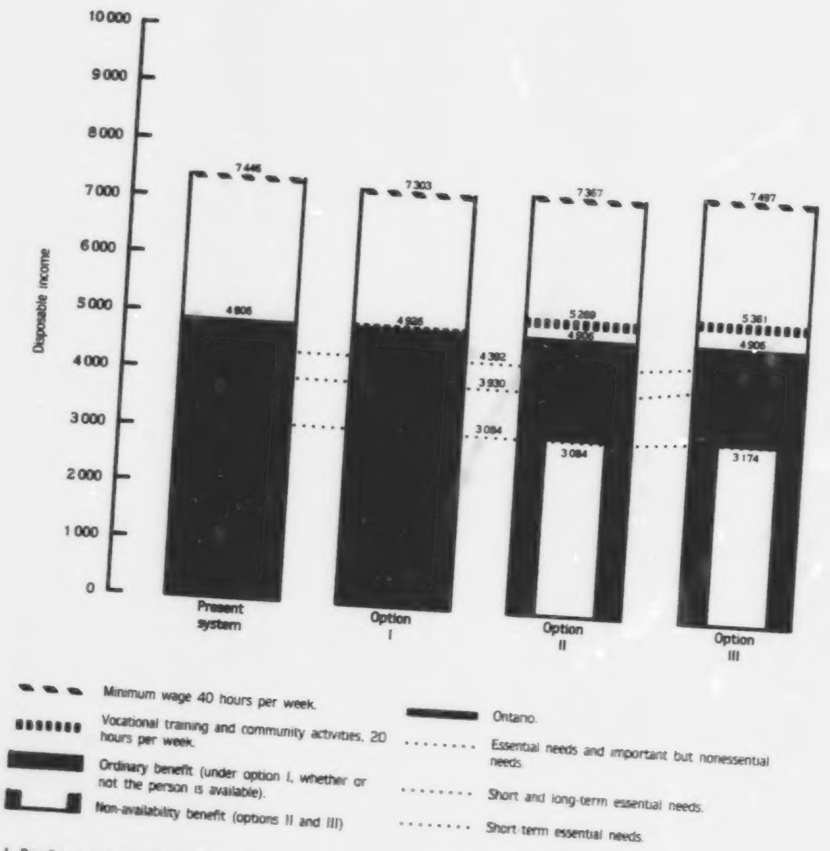
C: Increase in net hourly wage following a person's entry onto the labour market

D: Québec tax and transfer systems

Diagram VI.8

Single person between 30 and 64, without dependents, sharing a separate dwelling

A. Comparison of disposable income[1] Following the implementation of the reform
(in dollars based on 1983 benefits).



B: Impact of the various proposals on the net contribution to government expenditures
(in dollars)

Employment income of household	Net contribution			
	Present system	Option I	Option II	Option III
8 000	1 121	1 258	1 199	1 178
10 000	2 018	2 021	1 970	1 965
12 000	2 819	2 811	2 764	2 756
15 000	4 066	4 068	4 034	3 900

Employment income of household	Change in net contribution Option — Present system		
	Option I	Option II	Option III
8 000	138	78	57
10 000	3	- 48	- 53
12 000	9	- 55	- 63
15 000	2	- 32	- 86

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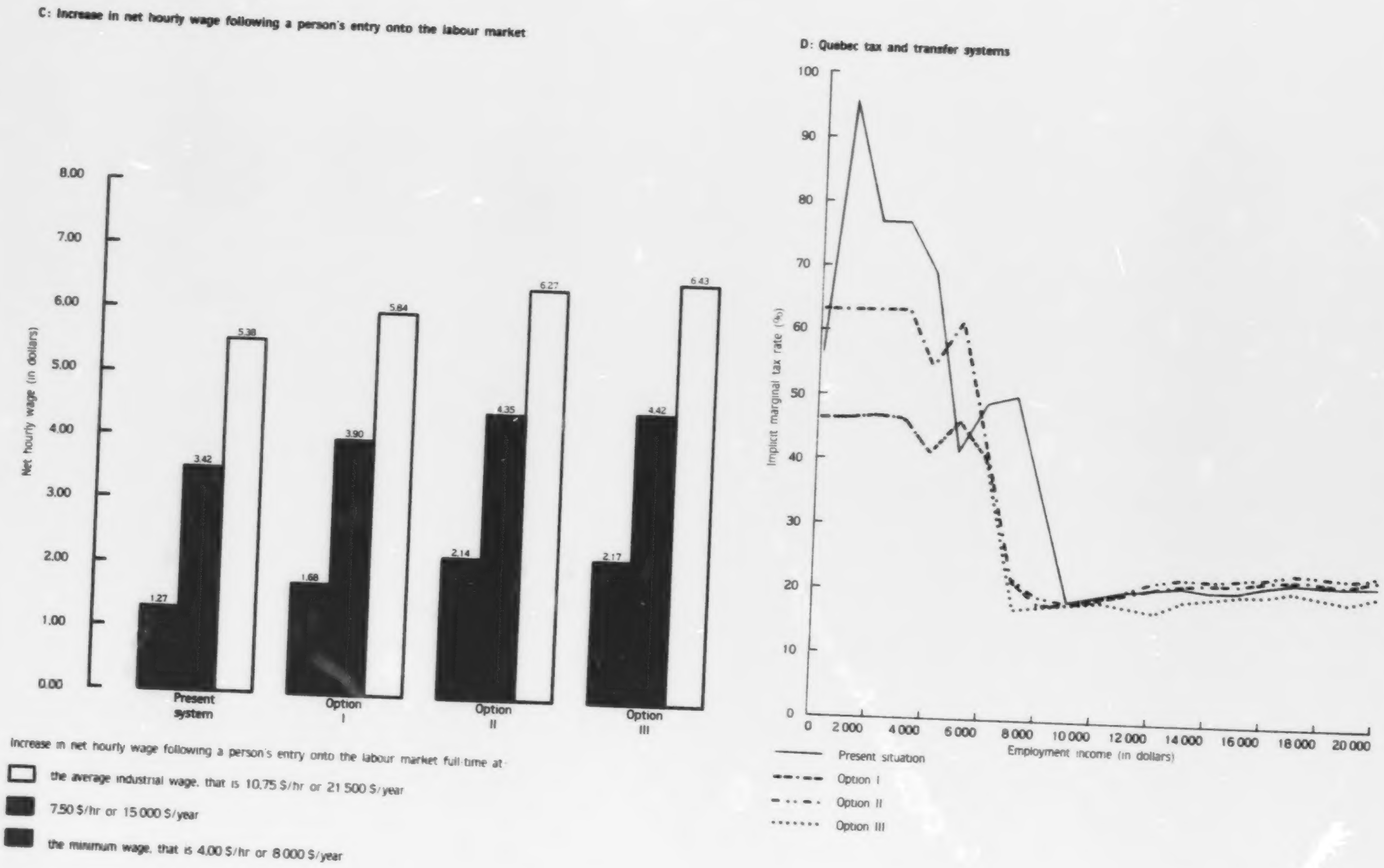
1. Beneficiary sharing a dwelling with an adult who does not belong to his immediate family (father, mother, child).

Diagram VI.8 (continued)

Single person between 30 and 64, without dependents, sharing a dwelling.



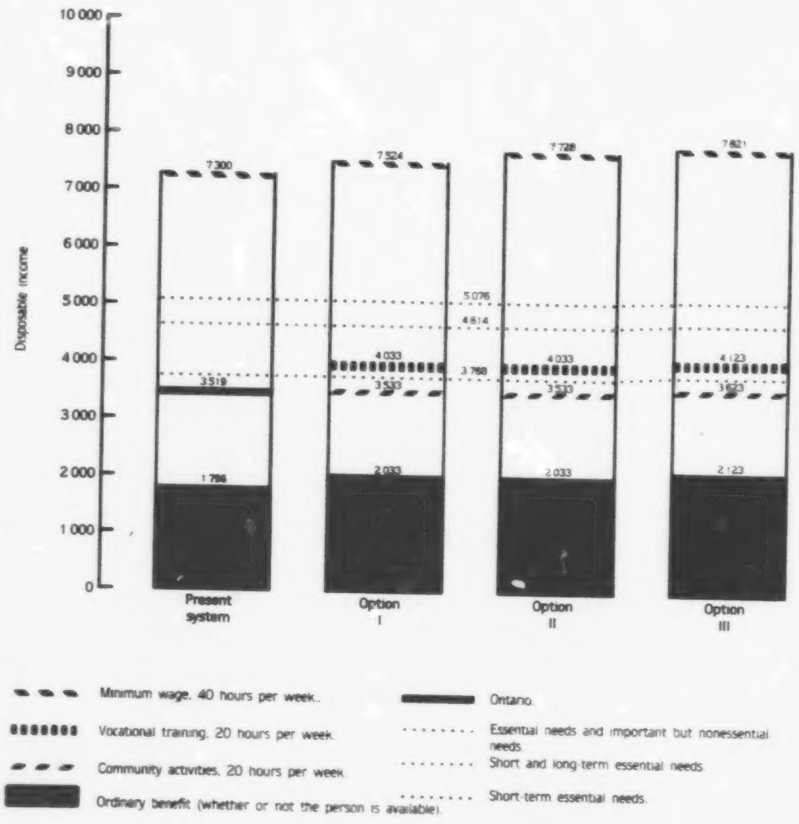
C: Increase in net hourly wage following a person's entry onto the labour market

D: Quebec tax and transfer systems

Diagram VI.9

Single person under 30, without dependents, living alone in a separate dwelling[1]

A. Comparison of disposable income.
Following the implementation of the reform
(in dollars based on 1983 benefits).



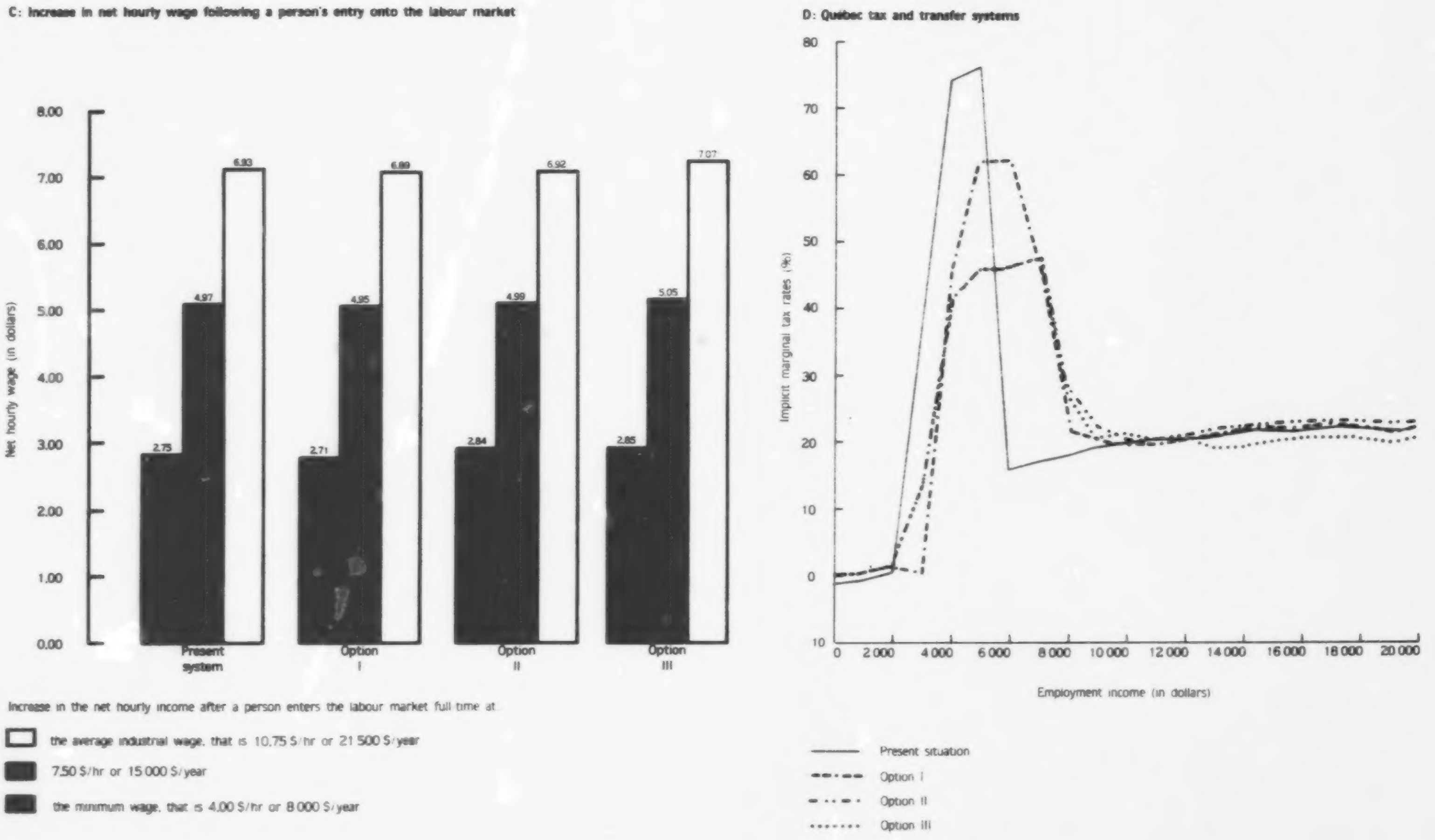
B: Impact of the various proposals on the net contribution to government expenditures
(in dollars)

Employment income of household	Net contribution			
	Present system	Option I	Option II	Option III
8 000	1 294	1 090	900	916
10 000	2 068	1 908	1 796	1 791
12 000	2 877	2 694	2 597	2 614
15 000	4 156	3 979	3 881	3 865

Employment income of household	Change in net contribution Option — Present system		
	Option I	Option II	Option III
8 000	204	394	378
10 000	160	272	277
12 000	183	281	263
15 000	177	275	291

Diagram VI.9 (continued)

Single person under 30, without dependents, living alone in a separate dwelling[1]



C: Increase in net hourly wage following a person's entry onto the labour market

D: Québec tax and transfer systems

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1. For persons between 21 and 24, the benefits under the income guarantee program are the same as for persons between 25 and 29. However, the additional income provided for reintegration activities is lower in their case, as shown in Table V.2.

year under options II and III, giving the recipient a higher income than under the present social aid program.

The second diagram examines the situation of a couple with two children under 6 (one under 2 and the other between 2 and 5). Part A of the diagram shows that, compared with the existing system, option I provides barely $15 more to persons who are not active, and that under options II and III, persons who are available are guaranteed the same amount of disposable income as under the existing system. In addition, options II and III provide $300 more to persons who are not available than when the children are between 6 and 11, because of the availability allowance which is maintained for children under 2. Finally, regardless of the age of the children, there is no difference in the increase in income derived from participation in reintegration activities.

In the first two diagrams, part B shows that the proposed reform would enable couples with children and one spouse working to significantly reduce their net contribution, as compared with the existing tax and transfer systems, by an amount varying according to income bracket and option. This is especially true for those with children between 6 and 11. For employment incomes between $8 000 and $15 000, the net contribution to government financing would drop by an amount varying between $367 and $1 298. For those earning the minimum wage option I is the most advantageous because of the high benefits, but when earnings approach $15 000 option III becomes more advantageous because of its significant reduction in income tax rates.

Part C changes very little in the first two diagrams, whether the children are between 6 and 11 or under 6. It shows that under the reform it is clearly in the interests of such a family for one of the spouses to enter the labour market. For example, if one of the spouses took a job at the minimum wage, his net hourly wage would rise from the present $0.84 to $1.45 under option I and to $2.06 under options II and III. At this income level the incentive to work is appreciably strengthened. At wages of $7.50 and $10.75 per hour, the options still allow improvement in net hourly wages, particularly within options II and III, and it is just as significant in dollar terms.

Finally, part D shows that the reform will correct the distortions in the present implicit marginal tax rate curve applicable when only one spouse earns employment income, and make it more uniform. This is particularly evident at the income level where transfers enter the picture. The level of the curve depends on the option selected. Up to $8 000 in income, all the options give rise to lower implicit marginal rates than under the present tax and transfer system. The same is true for income rising from $8 000 to $15 000 under options II and III; under option I, however, implicit marginal tax rates remain high, 67% up to income of $15 000, which is higher than under the present system, when one of the spouses receives employment income supplement benefits. Implicit marginal rate curves therefore make it possible to assess the incentive to work for all rates of income increases, but the results are parallel to those shown in the diagram on the net hourly wage.

6.1.2.2 Other categories in which the head of household is over 30

For other categories of low-income households whose head is over 30, the effects of the reform are similar. Although levels of disposable income before and after the reform differ from one category to another, the effect of the changes remains the same. For example, option I gives the highest disposable income for those who are inactive, whether or not they are available. On the other hand, under options II and III it is possible to obtain additional income for taking part in reintegration activities (to a maximum of 20 hours per week).

In the same way it can be seen that all the options strengthen the incentive to work; part C of the diagrams shows, for all categories of households, that the net hourly wage increases progessively from the present system to option I, from option I to options II and III.

The category of low-income households benefiting least from the reform is that of single persons sharing a dwelling with others. Although there is provision for restricting the change to those who enter this category after the reform, for them the changes mean a simultaneous drop in income and increase in the net contribution to government financing under options II and III.

Table VI.5

Annual remuneration in the underground labour market equivalent to disposable employment income on the official market
(in dollars)

Type of household	Regular gross income on the official market	Income from work in the underground economy necessary to obtain equivalent disposable income on official market			
		Present	Option I	Option II	Option III
Single person 21-29					
▪ Minimum wage	8 000	5 504	5 491	5 695	5 698
▪ Intermediate wage	15 000	9 944	9 898	9 993	10 089
▪ Average industrial wage	21 500	13 856	13 794	13 853	14 129
Single person 30-64					
▪ Minimum wage	8 000	2 552	2 924	3 989	3 989
▪ Intermediate wage	15 000	6 852	7 292	8 247	8 340
▪ Average industrial wage	21 500	10 720	11 188	12 107	12 380
Single person 30-64 Sharing a housing unit					
▪ Minimum wage	8 000	2 540	3 373	4 283	4 323
▪ Intermediate wage	15 000	6 828	7 802	8 685	8 826
▪ Average industrial wage	21 500	10 746	11 685	12 530	12 850
Couple 30-64 Childless 1 spouse working					
▪ Minimum wage	8 000	1 886	2 919	4 139	4 142
▪ Intermediate wage	15 000	5 443	5 783	7 607	7 666
▪ Average industrial wage	21 500	9 560	9 710	11 483	11 599
Couple — 2 children under 6[1] 1 spouse working					
▪ Minimum wage	8 000	1 699	2 912	4 118	4 123
▪ Intermediate wage	15 000	4 623	4 999	7 318	7 327
▪ Average industrial wage	21 500	8 534	8 899	11 222	11 392
Couple — 2 children between 6 and 11 1 spouse working					
▪ Minimum wage	8 000	1 669	2 906	4 114	4 116
▪ Intermediate wage	15 000	4 590	4 993	7 314	7 321
▪ Average industrial wage	21 500	8 503	8 893	11 222	11 390

1. One of the children is under 2, the other between 2 and 5.

6.1.2.3 Single persons under 30 without dependents

Under the current transfer system, single persons under 30 living alone, who are inactive but considered able to work receive lower benefits than older beneficiaries. The reform will not change things much for these persons, except for the higher property tax refund and the new sales tax credit. The ordinary benefits, on account of these two elements, will increase by an annual amount of $237 to $327 depending upon the option.

However, if a single person under 30 takes part in reintegration activities, his disposable income will increase. These activity programs will enable him to take care of his short-term essential needs by participating in community activity. Participation in vocational training or education programs for 20 hours a week will enable them to defray more than the cost of their short-term essential needs but not to fully cover their short and long-term essential needs. Part A of Diagram VI.9 shows the impact of these programs on single persons between 25 and 29. For those 21 to 24, however, the income granted for such activities must be reduced by $500 given the lower remuneration they earn from participating (see Table V.2).

It is to be noted that the proposed reform will moderate the curve of implicit marginal rates for single persons under 30: benefits under the income guarantee program are first reduced at a higher income level than under the current system. This practically does not change this group's interest in working full-time, as indicated by the net hourly wage in part C of the diagram; however, it would be more attractive to accept part-time or intermittent work than is now the case. Therefore, and this is equally valid for all single persons between 21 and 29 inclusive, the increase in the net hourly wage as a result of employment at the minimum wage for 20 hours per week is $3.65 under the existing tax and transfer systems, and would rise to $3.85 under options II and III.

Finally, it should be noted that this taxpayer's net contribution to government financing will decline under all the options, and in all levels of income considered. In this respect, options II and III are the most advantageous, as one of their main objectives is to further encourage low-income wage earners to work.

6.1.2.4 Conclusion

The effects of the reform on taxpayers with no or low income are doubly positive. On the one hand, the net gains from their efforts are increased, particularly under options II and III. This increased incentive applies to regular employment and activities designed to enhance their "employability". On the other hand, these monetary incentives will result in increased disposable income for all those who take advantage of them, and should make the fight against poverty more effective. This question is taken up again in section 6.4.

The reform, because of the additional incentive to work that it offers, also makes work in the underground economy less appealing, as Table VI.5 indicates. This table illustrates, for certain types of households, the amount of remuneration in the underground labour market which is equivalent to disposable income derived from full-time employment on the official market, according to certain hypotheses respecting gross income, and the option chosen. For example, it will be seen that, under option III, the couple with two children will have to increase its income derived from working in the underground economy from $1 669 or $1 699, depending upon whether the children are between 6 and 11, or under 6, to $4 116 or $4 123 respectively to obtain the same disposable income as the one earning $8 000 on the official market. In other words, such a taxpayer will have to work almost two and one half times as long in the underground economy to obtain the same disposable income.

6.1.3 High-income taxpayers

For high-income taxpayers the reform proposes, as in the case of middle-income and most low-income groups, a reduction in their net contribution to government financing. In their case, however, the objective sought is primarily to make Québec's tax system more competitive with those in neighbouring regions, as well as fostering the incentive to work and reducing work in the underground economy and tax evasion. In this manner, Québec's comparative advantage with regard to cost of living could be put to better use as an economic development lever.

It is therefore important to illustrate how and to what degree the various options proposed can reduce the tax burden differential between Québec and Ontario, since comparisons with that province are most frequent. The comparison is made first without considering the Stock Savings Plan (SSP), and then taking it into account. Although the SSP is a fiscal measure open to all taxpayers in Québec, it involves risks and costs which reduce its attraction for financially inexperienced taxpayers. In addition, the taxpayer is responsible for deciding whether to use it. This is why the impact of the reform is examined with and without taking the SSP into account.

Tables VI.6 and VI.7 show the present tax burden differential between Québec and Ontario, while Graph VI.1 shows the current average tax rate, and what they would be under each of the options, by type of household and income bracket. Table VI.6 deals with middle-income taxpayers, since a comparison of their taxes with those of similar taxpayers in Ontario can be interesting even though the inability of Québec's present tax system to compete does not really arise at such income levels.

The first general observation which can be made in this regard is a corollary of those made regarding middle-income taxpayers. Since these taxpayers benefit from the various options, their tax burden differential compared with what it would be under Ontario's tax structure is reduced accordingly. Among the three options considered, option III, based on a tax table with lower marginal rates, reduces the tax burden differential most significantly. For example, for a couple with two children and only one spouse working outside the home, earning $50 000, the tax burden differential would drop, under this option, from $2 050 to $686 when the children are between 6 and 11, and from $1 591 to $415 when they are under 6. If the taxpayer earns less than $50 000, the difference is even less, even becoming negative at incomes of $30 000 and under, depending on the age of the children.

Graphs VI.1 A to VI.1 E illustrate the overall tax burden, without taking advantage of the SSP, as a percentage of household income, and are aimed at middle and high-income taxpayers. They also illustrate, under the existing system and option II, the level of income, for each type of household, at which the taxpayer's tax burden under Québec's tax structure begins to exceed what it would be under Ontario's structure. For the couple with two children between 6 and 11 and one spouse working outside the home, the income threshold at which total taxes are equal under the two tax structures rises almost $10 000, from $24 800 to $34 500. The corresponding rise for a couple with two children under 6 is $7 000, producing an income threshold of $38 000. Furthermore, the average tax rate for this type of household is quite close to what it would be under the Ontario tax structure up to an income of $60 000. For childless couples and single persons, the income at which total taxes are equal under the two tax structures is slightly higher under option II than under the current system. The average tax rates on incomes in excess of this threshold are, however, significantly closer to the Ontario rates under option II. Finally, with respect to families in which both spouses work outside the home, the threshold of income at which total taxes are higher under the Québec tax structure than under Ontario's increases by $7 000, reaching $37 900. However, when income is over $50 000, the average tax rates remain significantly higher than what they would be under the Ontario structure.

Table VI.7 deals with high-income taxpayers. It illustrates the tax reduction brought about by the reform depending on whether a taxpayer invests in an SSP the average amount invested in such a plan in 1981 by Québec taxpayers with similar incomes. The table shows that the reform offers taxpayers earning $75 000 who do not make use of the SSP tax burden reductions of about $1 000 under options I and II, and in the range of $2 000 in option III. Average use of the SSP can substantially decrease the tax burden differential compared with Ontario for these taxpayers. In option III, the differential falls to under $2 000 for single persons and under $1 000 for couples. At present the tax burden differential stands at about $5 000 for single persons and $4 000 for couples if they do not use the SSP.

Furthermore, at an income of $150 000, the tax burden differential between Ontario and Québec taxpayers, which at present comes to about $12 000 for single persons and $10 000 for couples if they do not invest in an SSP, could be reduced by between $2 000 and $3 000 in options I and II and by $4 000 to $5 000 in option III. Should these taxpayers make an average use of the SSP, tax burden differentials under option III would be about $5 000 for single persons and a little less than $4 000 for couples. Compared with the present situation, option II leads to a 50 percent reduction in the tax burden differential for taxpayers earning an income of $150 000 if they participate in the SSP.

Table VI.6

Impact of various options on the tax burden[1] differential compared with Ontario
(in dollars)

Type of household	Employment income	Tax burden under present system	Québec-Ontario differential[2]			
			Under present system	According to different options: Option I	Option II	Option III
1. Couple with two children under 6[3] One spouse works	15 000	1 000	−1 011	−1 473	−1 501	−1 526
	18 000	2 281	−903	−1 279	−1 397	−1 465
	21 500	3 798	−714	−1 044	−1 134	−1 246
	25 000	5 349	−467	−827	−903	−948
	30 000	7 897	−76	−562	−584	−635
	40 000	13 387	792	151	177	−52
	50 000	18 885	1 591	760	822	415
2. Couple with two children between 6 and 11 One spouse works	15 000	1 471	−540	−1 197	−1 225	−1 256
	18 000	2 755	−428	−1 001	−1 119	−1 194
	21 500	4 275	−237	−767	−856	−956
	25 000	5 829	13	−555	−609	−679
	30 000	8 375	402	−289	−311	−340
	40 000	13 872	1 277	426	451	217
	50 000	19 344	2 050	1 035	1 098	686
3. Childless couple 30-64 One spouse works	15 000	2 877	−580	−825	−945	−1 026
	18 000	4 159	−471	−650	−741	−840
	21 500	5 676	−263	−424	−497	−555
	25 000	7 220	−30	−219	−263	−356
	30 000	9 620	374	98	78	−101
	40 000	14 619	1 285	885	919	556
	50 000	20 039	2 052	1 524	1 587	1 048
4. Single person 30-64	15 000	4 181	7	−126	−225	−230
	18 000	5 510	194	42	−32	−109
	21 500	7 041	484	321	266	119
	25 000	8 641	760	583	552	327
	30 000	11 030	1 165	958	954	624
	40 000	16 067	2 084	1 775	1 807	1 283
	50 000	21 561	2 953	2 481	2 546	1 815
5. Single person 30-64 Sharing a dwelling	15 000	4 066	52	54	20	−34
	18 000	5 338	201	230	212	99
	21 500	6 838	503	537	539	341
	25 000	8 418	789	817	838	567
	30 000	10 791	1 184	1 188	1 236	879
	40 000	15 851	2 088	1 997	2 088	1 520
	50 000	21 386	2 934	2 688	2 812	2 040
6. Couple with two children 6-11 Both spouses work	25 000	3 733	−268	−749	−844	−684
	30 000	5 917	−23	−485	−592	−518
	40 000	10 656	626	195	142	6
	50 000	15 109	1 453	1 002	1 005	673
	60 000	19 815	2 211	1 687	1 745	1 238

[1] The tax burden is the net amount of taxes and contributions to the QPP or CPP and unemployment insurance.

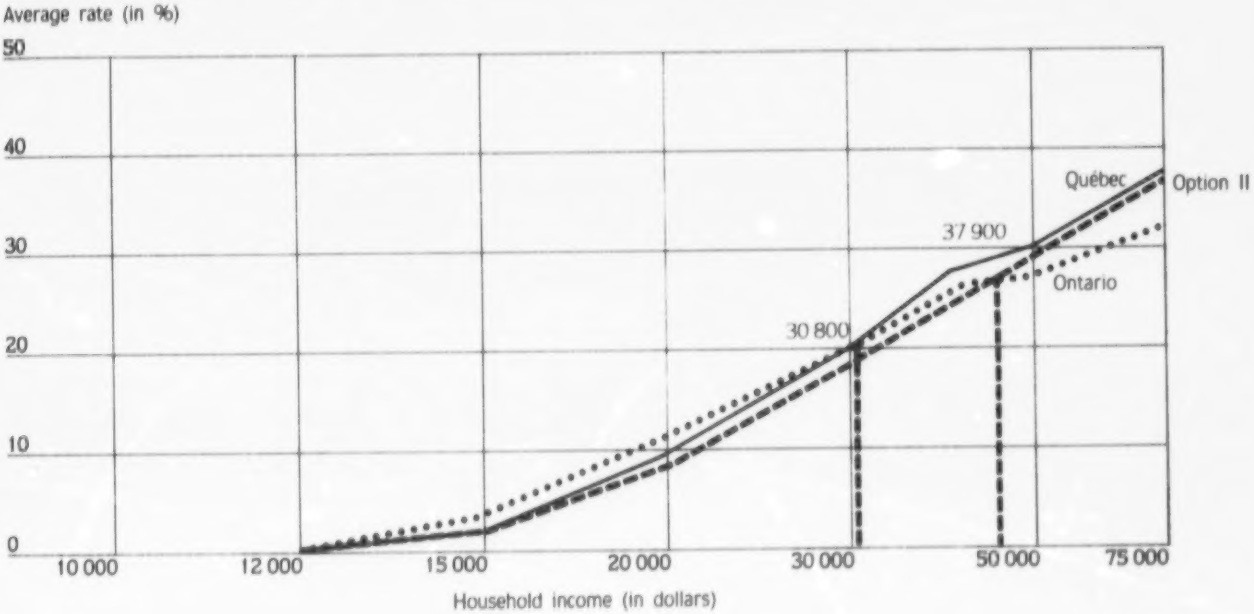
[2] A negative figure indicates a lower tax burden in Québec.

[3] One of the children is under 2, the other between 2 and 5. Under each option, a second child under 2 would reduce the tax burden by $200 because of the availability allowance.

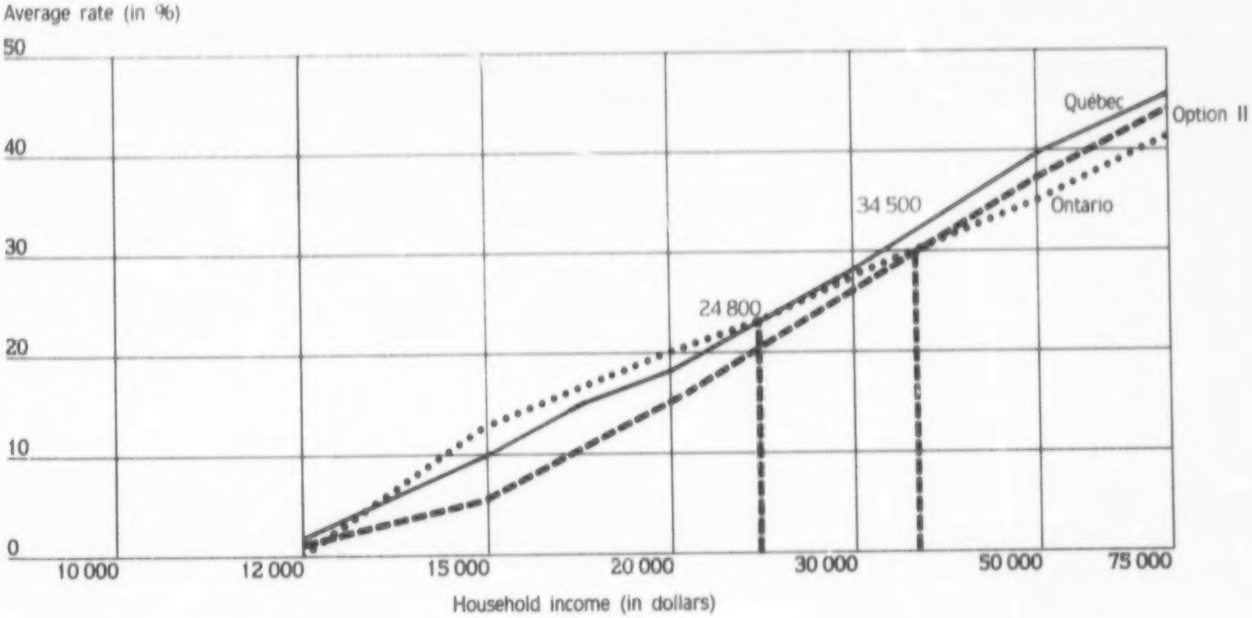
Graph VI.1

Overall tax burden as a percentage of household income, by income bracket. Québec and Ontario, 1983

A) Couple with two children between 6 and 11; both spouses work



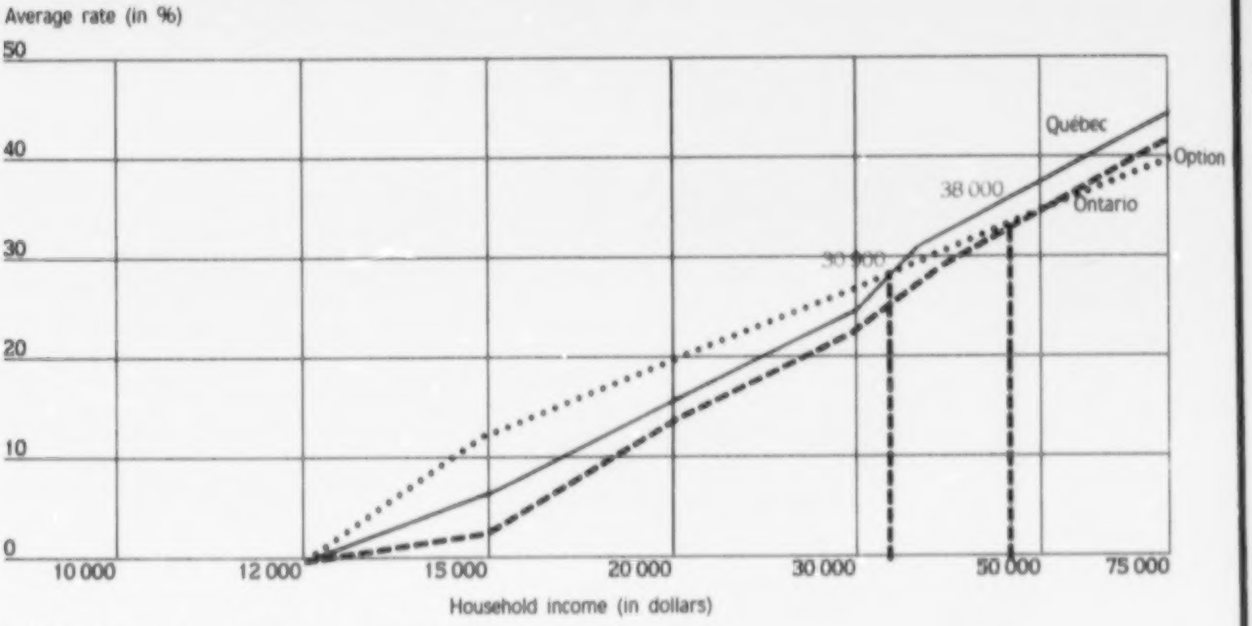
B) Couple with two children between 6 and 11; one spouse works



Graph VI.1 (continued)

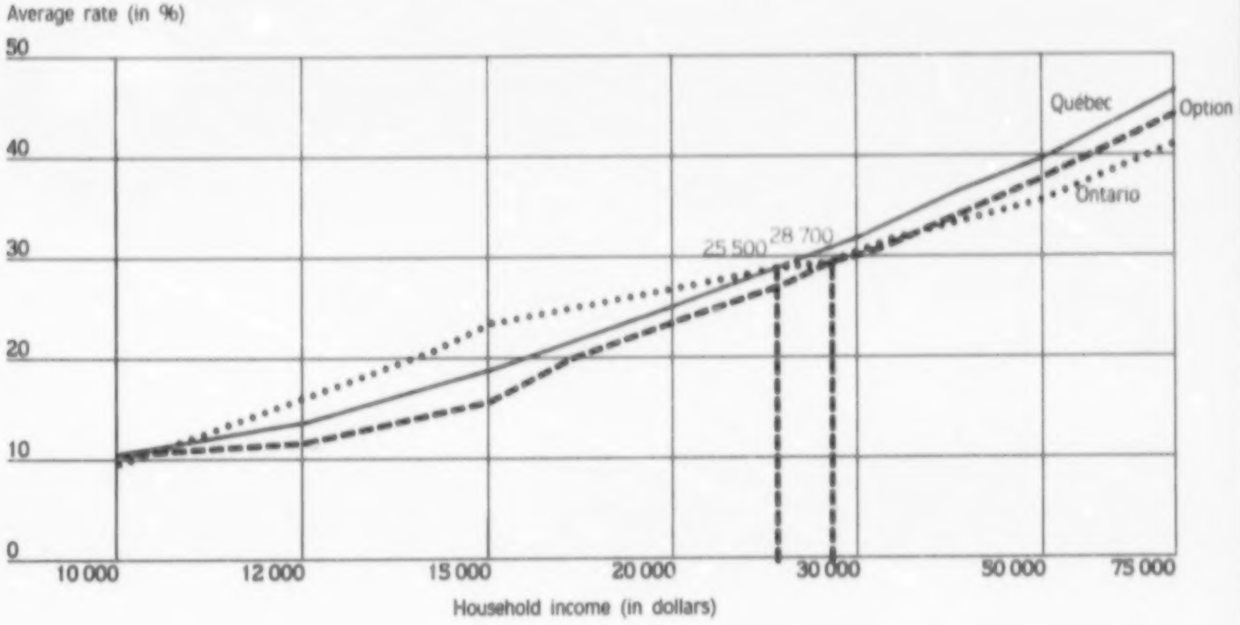
Overall tax burden as a percentage of household income, by income bracket. Québec and Ontario, 1983

C) Couple with two children under 6; one spouse works[1]



[1] One child is under 2 and the other is between 2 and 5.

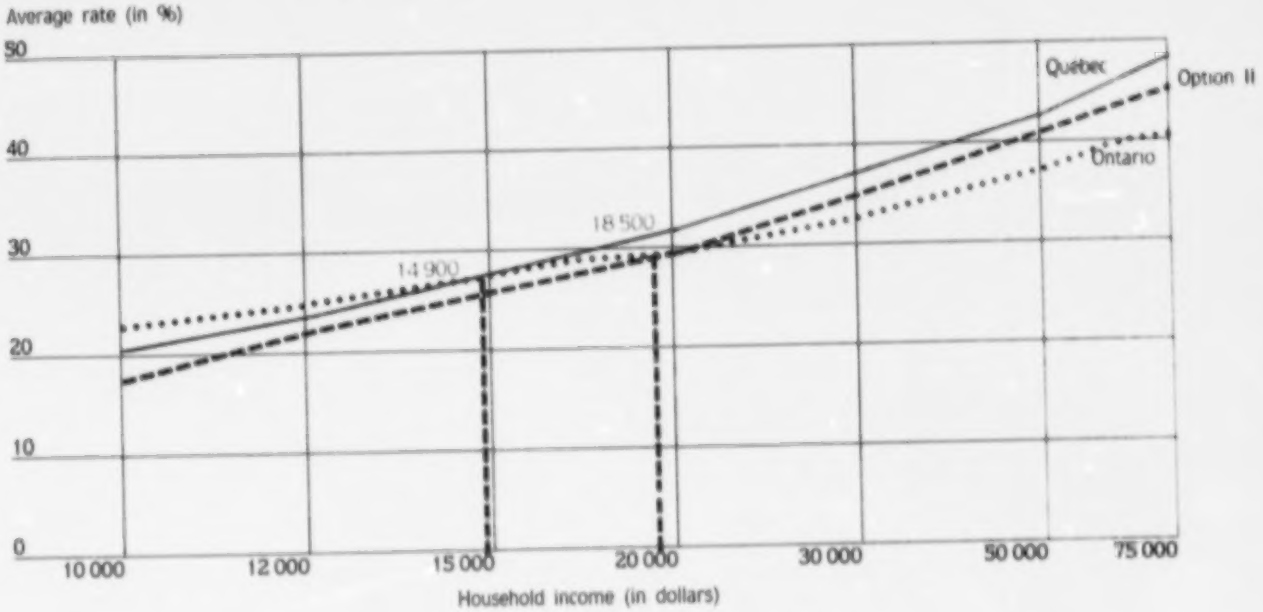
D) Childless couple: one spouse works



Graph VI.1 (continued)

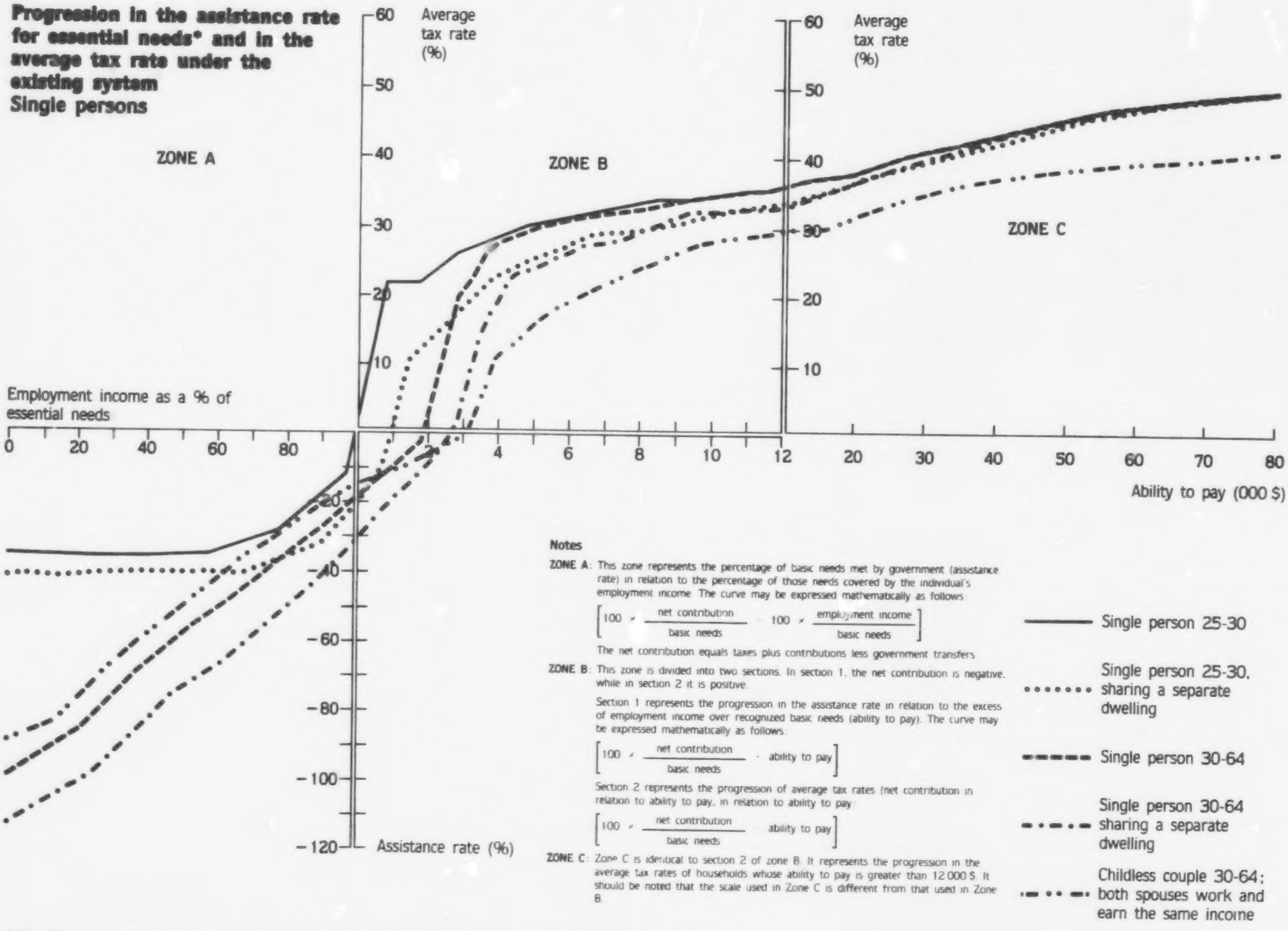
Overall tax burden as a percentage of household income, by income bracket. Québec and Ontario, 1983

E) Single person with no dependents



Graph VI.2

Progression in the assistance rate for essential needs* and in the average tax rate under the existing system
Single persons



Notes

ZONE A: This zone represents the percentage of basic needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div 100 \times \frac{\text{employment income}}{\text{basic needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized basic needs (ability to pay). The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

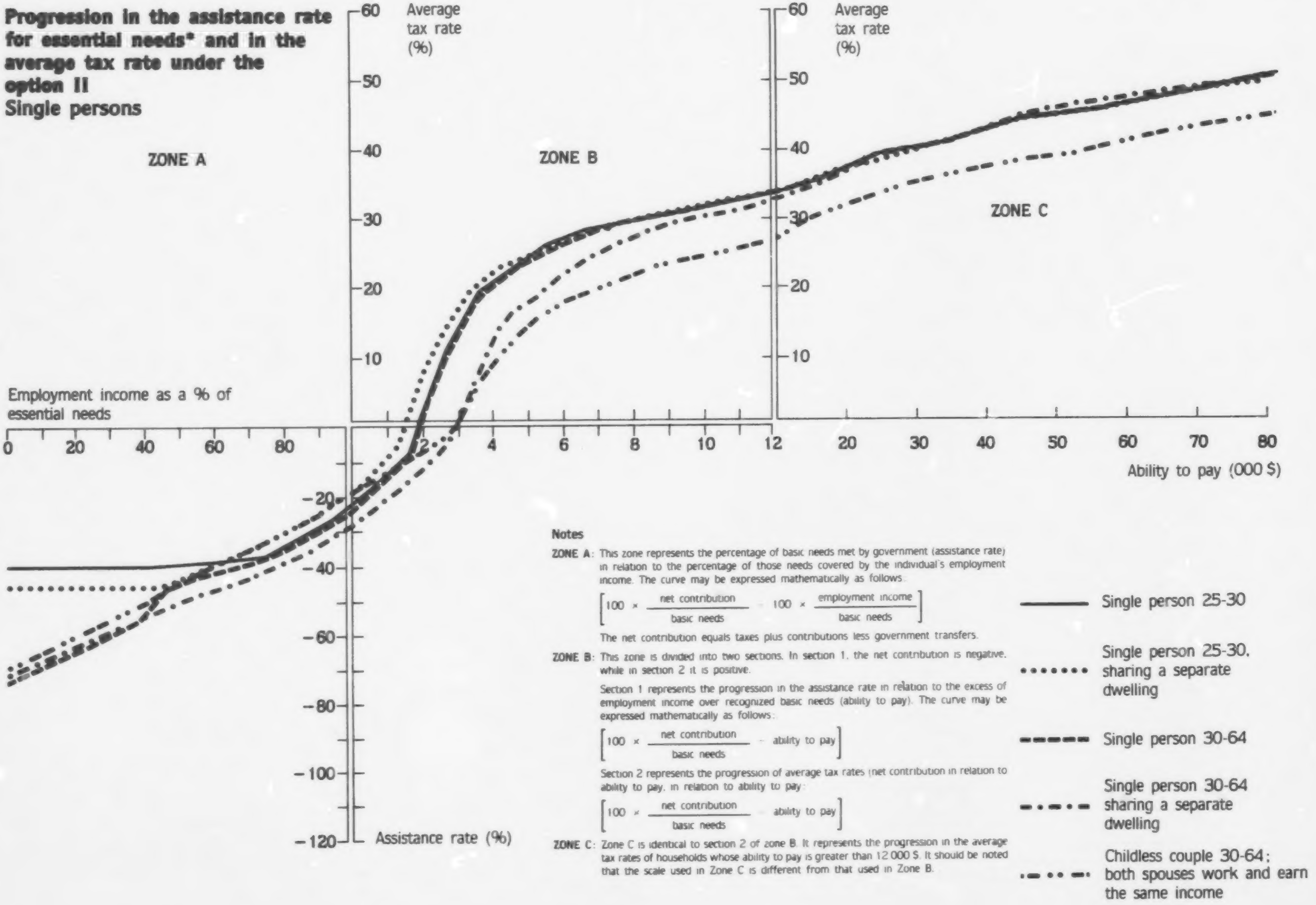
$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

* Essential needs are taken as including both short and long term essential needs and those which are important but nonessential.

Graph VI.2 (continued)

Progression in the assistance rate for essential needs* and in the average tax rate under the option II
Single persons



Notes

ZONE A: This zone represents the percentage of basic needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div 100 \times \frac{\text{employment income}}{\text{basic needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized basic needs (ability to pay). The curve may be expressed mathematically as follows:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

$$\left[100 \times \frac{\text{net contribution}}{\text{basic needs}} \div \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

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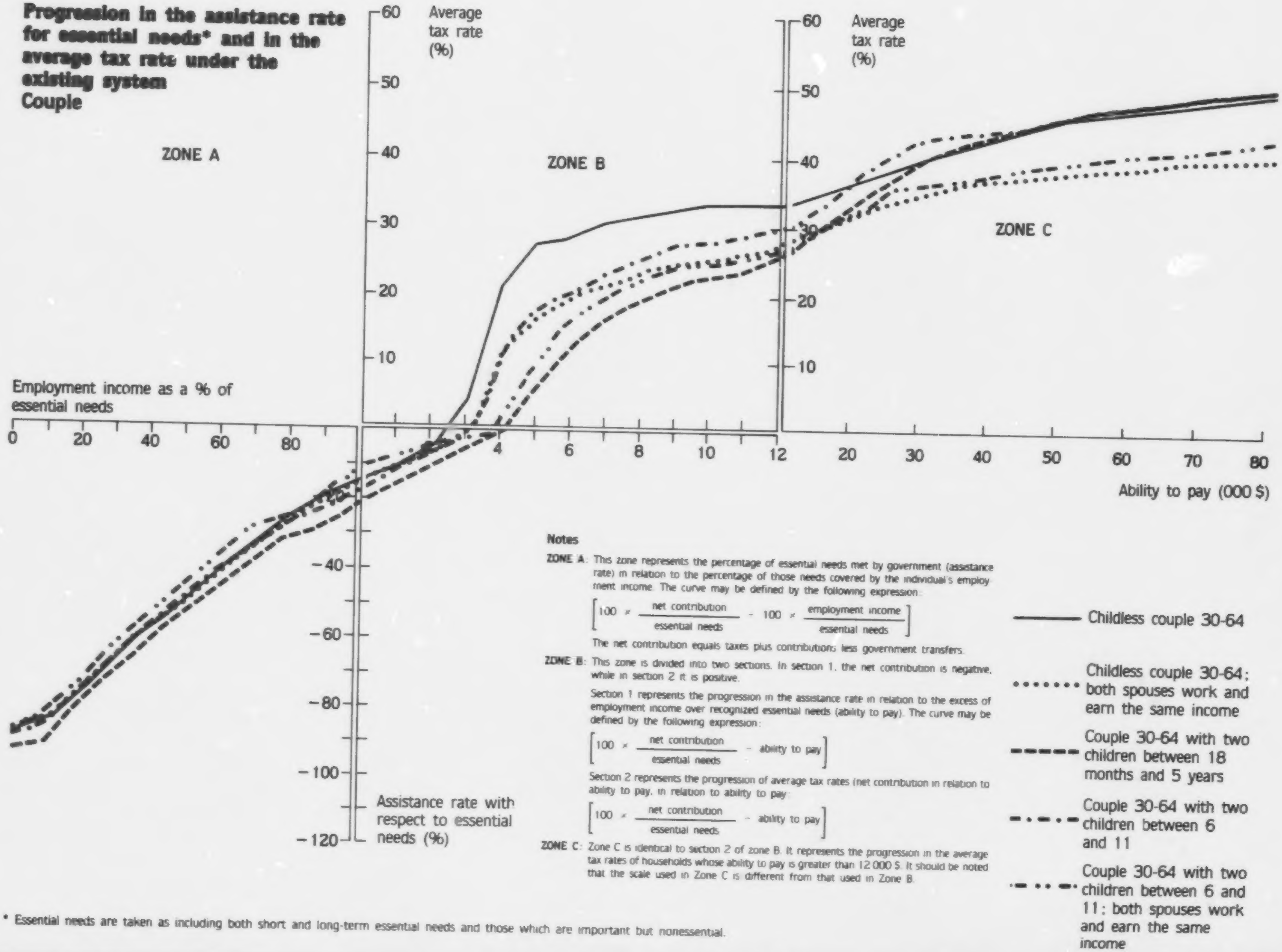
* Essential needs are taken as including both short and long-term essential needs and those which are important but nonessential.

Graph VI.3

Progression in the assistance rate for essential needs* and in the average tax rate under the existing system
Couple



Notes

ZONE A: This zone represents the percentage of essential needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - 100 \times \frac{\text{employment income}}{\text{essential needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized essential needs (ability to pay). The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

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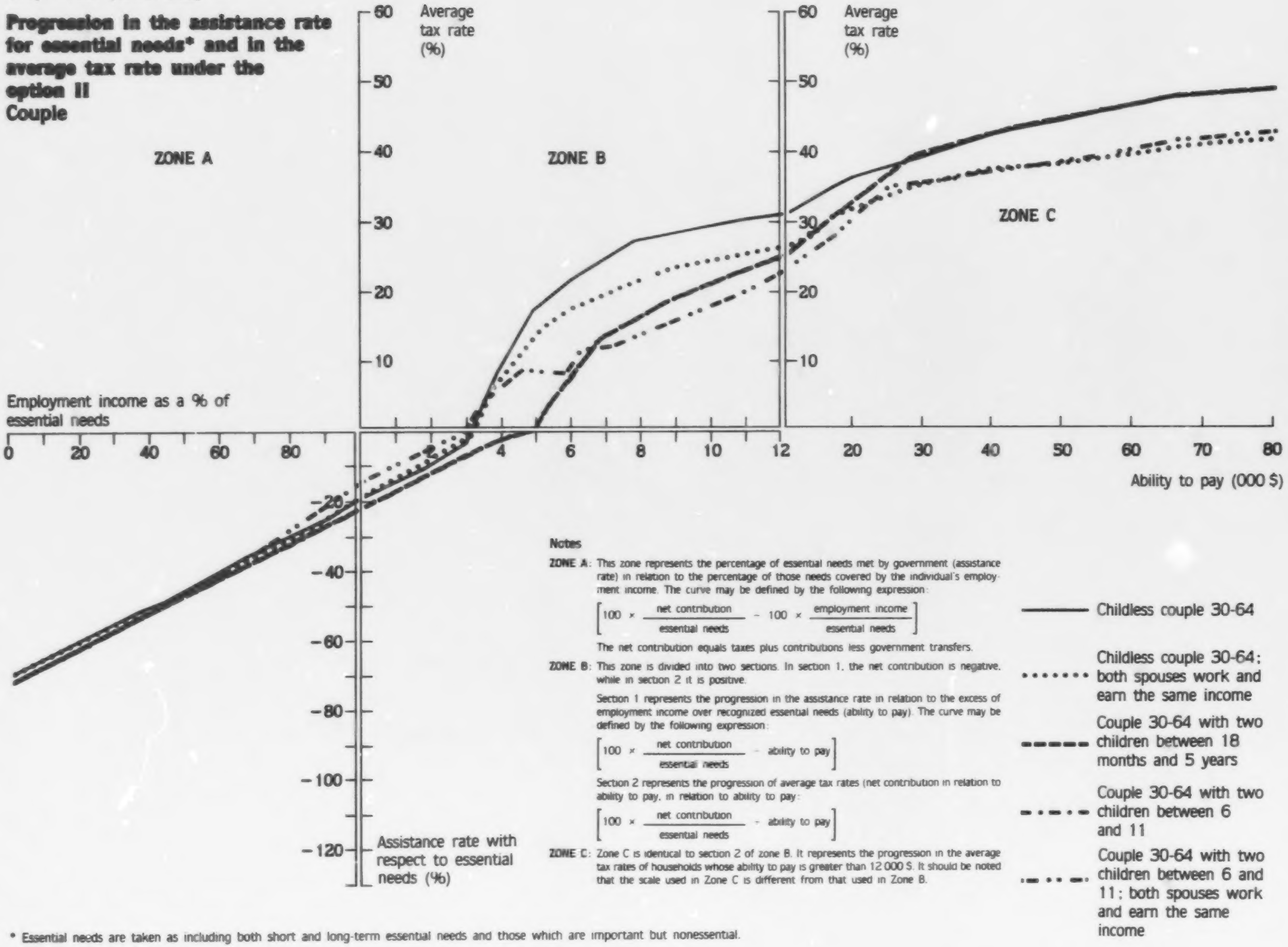
* Essential needs are taken as including both short and long-term essential needs and those which are important but nonessential.

Graph VI.3 (continued)

Progression in the assistance rate for essential needs* and in the average tax rate under the option II
Couple



Notes

ZONE A: This zone represents the percentage of essential needs met by government (assistance rate) in relation to the percentage of those needs covered by the individual's employment income. The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - 100 \times \frac{\text{employment income}}{\text{essential needs}}\right]$$

The net contribution equals taxes plus contributions less government transfers.

ZONE B: This zone is divided into two sections. In section 1, the net contribution is negative, while in section 2 it is positive.

Section 1 represents the progression in the assistance rate in relation to the excess of employment income over recognized essential needs (ability to pay). The curve may be defined by the following expression:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - \text{ability to pay}\right]$$

Section 2 represents the progression of average tax rates (net contribution in relation to ability to pay, in relation to ability to pay:

$$\left[100 \times \frac{\text{net contribution}}{\text{essential needs}} - \text{ability to pay}\right]$$

ZONE C: Zone C is identical to section 2 of zone B. It represents the progression in the average tax rates of households whose ability to pay is greater than 12 000 $. It should be noted that the scale used in Zone C is different from that used in Zone B.

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* Essential needs are taken as including both short and long-term essential needs and those which are important but nonessential.

Table VI.7

Québec-Ontario tax burden differential with and without an average investment[1] eligible for the Québec Stock Savings Plan (SSP)
By employment income of household
(in dollars)

	50 000 $		75 000 $		100 000 $		150 000 $	
	Without SSP	With SSP	Without SSP	With SSP	Without SSP	With SSP	Without SSP	With SSP
1. Couple with two children under 6[2] One spouse works								
Present system	1 591	652	3 643	2 140	5 747	3 345	9 964	7 292
Option I	760	-127	2 285	917	3 856	1 604	7 139	4 633
Option II	822	-81	2 384	1 016	3 948	1 698	7 231	4 728
Option III	415	-395	1 656	405	2 923	859	5 631	3 336
2. Couple with two children between 6 and 11 One spouse works								
• Present system	2 050	1 112	4 105	2 604	6 209	3 809	10 429	7 757
• Option I	1 035	149	2 564	1 194	4 134	1 883	7 416	4 913
• Option II	1 098	195	2 663	1 293	4 226	1 975	7 510	5 005
• Option III	686	-124	1 928	677	3 195	1 132	5 904	3 608
3. Childless couple One spouse works								
• Present system	2 052	1 103	4 145	2 625	6 298	3 868	10 615	7 910
• Option I	1 524	612	3 089	1 704	4 724	2 444	8 093	5 557
• Option II	1 587	675	3 189	1 804	4 817	2 537	8 186	5 650
• Option III	1 048	209	2 283	1 011	3 580	1 486	6 310	3 976
4. Single person 30-64								
• Present system	2 953	1 963	5 184	3 626	7 458	4 982	12 017	9 263
• Option I	2 481	1 560	4 141	2 729	5 920	3 601	9 517	6 937
• Option II	2 546	1 615	4 233	2 822	6 006	3 686	9 602	7 023
• Option III	1 815	963	3 057	1 755	4 430	2 285	7 247	4 859
5. Single person 30-64 Sharing a dwelling								
• Present system	2 934	1 954	5 185	3 628	7 458	4 983	12 017	9 264
• Option I	2 688	1 777	4 383	2 972	6 169	3 851	9 768	7 186
• Option II	2 812	1 884	4 528	3 118	6 308	3 988	9 905	7 325
• Option III	2 040	1 198	3 310	2 009	4 690	2 544	7 508	5 119
6. Couple with two children 6-11 Both spouses work								
• Present system	1 453	763	3 425	2 092	5 340	3 452	9 591	6 562
• Option I	1 002	280	2 739	1 484	4 317	2 564	7 471	4 725
• Option II	1 005	267	2 891	1 590	4 543	2 774	7 753	5 009
• Option III	673	32	2 142	1 010	3 440	1 844	5 980	3 463

1. The average investment of taxpayers who received a deduction under the SSP in 1981 was 3 500 $ for an income of 50 000 $, 5 100 $ for one of 75 000 $, 8 100 $ for one of 100 000 $ and 9 000 $ for one of 150 000 $. These average investments are used for the typical households presented in this table.

2. One of the children is under two, the other is between 2 and 5.

With an average use of the SSP by taxpayers, the reform would enable the Québec tax system to become competitive with that of neighbouring provinces. As shown in Chapter II, residents of Québec enjoy a significant comparative advantage in terms of cost of living, particularly housing. Québec has, in fact, a large stock of quality housing at prices that are distinctly more affordable than those being paid elsewhere in Canada and most industrialized countries for similar housing.

Québec has so far benefited little from this comparative advantage which was partly or entirely offset by its high taxes. The proposed reorganization of the tax system should enable Québec to benefit more from this asset in order to attract or hold the managerial and technical staff necessary to its economic development.

6.2 Equity in the Tax and Transfer System

If it is to be fair, a tax or transfer system must deal differently with taxpayers whose income and ability to pay differ. In assessing the ability to pay of individuals, households or families, the tax system must take account of the amount of income needed to pay for basic needs.

In a system in which it is accurately measured, ability to pay should be taxed in the same way for all categories of households. It is of course clear that marginal income tax rates may rise as ability to pay goes up, for this is the objective of any tax system that redistributes income. However, given the same ability to pay, the average income tax rate should not vary in terms of civil status or any other personal attribute.

Graphs III-4 and III-5 presented in Chapter III and reproduced here show that, under the present system, households with the same ability to pay but with varying social organizations pay different amounts of income tax, which runs counter to the objective of equity. By way of example, the graphs show that starting from a certain income level, the average tax rate on the ability to pay of couples in which both spouses work is always less than for other categories of households. On the other hand, graphs VI.1 and VI.2 illustrate the effects of option II, which brings the curves much closer together or, in other words, reduces the disparities in the tax treatment of the various categories of taxpayers.

It is important to note, first, that the reform makes the system more equitable by reducing certain unwarranted differences in fiscal treatment among various categories of taxpayers, or by taking more fully into account the essential needs specific to other categories. It gives greater consideration to the additional costs of housing incurred by single persons who live alone compared with those who share living quarters with other adults. Option II would have the effect of reducing the tax burden of a single person earning $30 000 by somewhat more than $200 if he lives alone.

In the same way, the essential needs of the children of a two-parent family will be more fully taken into account by the tax system. A couple with two children over six and a single employment income of $30 000 now pays $1 245 less in taxes than a childless couple. After the reform, the differential will go up to $1 662, under option II, to more fully cover the additional cost of children in the family.

The reform also reduces the disparities resulting from different tax treatment for couples in which only one spouse works and in which both spouses work. For example, a childless couple earning $30 000 nows pays $1 295 less in taxes if their reduce the differential to about $1 062. There is still it is earned entirely by one spouse. Option II would reduce the differential to about $950. There is still a substantial difference between the tax burdens of these two couples, whose ability to pay is basically similar. However, a disparity must be maintained to allow for coverage of the expenses involved in the second spouse's participation in the labour market, which may in some cases be considerable.

It is also to be noted that, even allowing for the effect of the proposed reform, once the zero tax threshold is reached, the differential in the tax burden between couples and single persons tends to widen in absolute terms as incomes increase. This can be explained by the coming into effect, at this level of income, of the lump-sum tax reduction, which is highest for couples and which was designed to reduce the high implicit marginal tax rates among taxpayers who are transfer recipients. This is one of the basic premises of the reform as explained in Chapter V, and which will be discussed in Chapter VII. Lastly, the reduction of discrepancies in tax treatment between categories of taxpayers could be more pronounced if the federal government were also to revamp personal exemptions in the direction taken by the reform.

Such disparities between the categories of households can also be seen in the transfer system (zone A of Graphs VI.1 and VI.2). When employment income is less than that needed for essential needs, the transfer system intervenes to make up all or part of the difference between income and needs. Zone A in Graphs VI.1 and VI.1 shows that the rate of coverage of essential needs is not the same for the various categories of households under the present transfer system, but that the means suggested by the reform would substantially reduce these disparities (option II is presented as an illustration).

With regard to child care costs, the diagrams do not enable us to see how the reform will be more equitable. The present deduction limit does not take into account all the costs of caring for preschool children in day care centres. On the other hand, this ceiling is too high in the case of children of school age who are cared for only a few hours a day. To correct the discrepancies, a new deduction has been proposed whose maximum would cover the costs in licensed child care centres and would be adjusted according to the age of the children. As Table VI.8 shows, this brings the maximum deduction into line with the actual cost of day care.

The grant for child care expenses would not necessarily be more generous but would be more universal, as it would apply to all forms of day care. Instead of covering only 15 000 children as is the case at present, it could affect some 60 000 children in options II and III and about 100 000 in option I. In the latter case, the number of children affected is greater because the income limit at which transfers are nil is higher.

Table VI.8

Comparison of child care costs and maximum deduction according to the age of the child
(in dollars)

	Under 6	**6 to 11**	**12 to 13**
Child care costs	3 120	1 560	—
Maximum deduction:			
• Present system	2 000	2 000	2 000
• Proposed system	3 120	1 560	—

6.3 Impact on Economic Efficiency

It is not sufficient to know how the new tax and transfer system will affect implicit marginal tax rates; to understand its real impact, the way in which taxpayers will react must be known. This is the purpose of this section.

The economic indicators used have been developed with the help of a numerical model representative of the whole of Québec's economy.[3] This model, briefly described in Chapter III, was built to measure the effects of various reforms of the personal tax system on a number of key variables, such as the overall level of economic efficiency, production, employment, income distribution and **tax receipts**.

6.3.1 Description of the numerical general equilibrium model

For a good understanding of the results provided by the **economic model**, it is advisable for us to give a general explanation of its operation. First, the model used is a micro-economic general equilibrium model. This means that the model takes account of the whole range of taxpayers' reactions to changes in their fiscal environment and, consequently, the results are more valid for the medium term (about five years) than for a short period (about one year). While the labour supply can adjust relatively quickly to the new environment, as shown by the reaction to the 1971 reform of the unemployment insurance program, it takes longer for the demand for labour to adjust to an increase in the labour supply by way of relative wages and the labour-capital ratio.

When the State alters a fiscal parameter (for example, the marginal income tax rate) or a parameter of the transfer system (for example, the basic minimum income), it changes the economic constraints on the basis of which economic agents make their decisions. This is why these changes are reflected in alterations in the behaviour of each of the economic agents directly affected; this is the partial micro-economic effect. These new types of behaviour on the part of each agent interact and determine the effects on markets as a whole; this is the general micro-economic effect. Finally changes in all the markets influence **net domestic product**, total employment, the tax revenues of governments and their transfer payments. This is the macro-economic effect.

For example, a decrease in the marginal income tax rates could be an incentive for everyone to increase his yearly hours of work (partial micro-economic effect). This increase in the labour supply could entail lower costs for hiring workers and encourage firms to increase their manpower demands. This would be reflected in increased employment, production and income (general economic effect on the private sector). For the public sector however, two major things have happened. Initially, the reduced tax rates have decreased tax revenues, but with time the additional economic expansion will enable the State to collect further revenues and pay less in transfers. Depending on the option and the strength of household reaction to the changes, the total of these changes in revenues and transfers could be higher or lower than the initial decrease in tax revenues.

In its present version, the model does not take account of the impact of increased sales tax revenue generated by an increase in the tax base which characterizes option III. The model makes use of a **lump-sum** (per capita) **tax** in order to keep the net government tax bite constant. It does not, therefore, enable us to measure the gain in economic efficiency resulting from substituting the sales tax for income tax.

Nor does the model take into account the possibility of workers' immigrating or emigrating. It follows that their reaction to fiscal parameters is limited to adjustment of their hours of work. For instance, one reaction to high tax rates in Québec may be to emigrate to countries or provinces where rates are lower. In this regard the model used surely underestimates the impact of the tax systems and therefore that of the reform since it appreciably reduces the tax burden differential of Quebecers. This economic impact is also underestimated in that the model does not consider the economic loss resulting from work in the underground economy, household breakup and reduced investment in human capital (education).

From the point of view of the labour supply, three classes of workers according to qualification level expressed by income in 1980 dollars (low qualifications, under $12 000, average qualifications,

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[3] This numerical general equilibrium model of the Québec economy was designed by Professors B. Fortin, H.P. Rousseau and P. Fortin of the Groupe de recherche en économie politique, Laval University. It was applied with the assistance of the ACSI consulting firm and officials of the ministère des Finances.

$12 000 to $25 000, and high qualifications, over $25 000) are further broken down according to age, sex and civil status. For each of the resulting 34 groups, the annual number of working hours offered stems from the interaction between preferences (for consumption and leisure time) and personal budget.

In a word, the model serves to illustrate the consequences in the medium term of reforms in a complex economy, which is highly interactive and very open to outside markets. Because of the model's limitations, the results supplied probably understate the impact of the reform, but can still be used as an order of magnitude, and make it possible to compare various ways, including the present, of structuring the tax system for the same deficit level, and clarifying the choice to be made between economic efficiency and income distribution.

6.3.2 Overall results provided by the model

The results are presented on the basis of two estimations. First, the model assumes an average reaction by households in their labour supply behaviour in the light of variations of parameters of the tax and transfer systems. Under this hypothesis, the model uses parameter values corresponding generally to the average of empirical estimates observed in the literature on labour supply. More recently, these estimates have been reassessed taking taxes into account and using more adequate econometric methods.[4] The results of this work provide estimates almost twice as high as traditional values; the model uses this assumption, qualified as strong reaction.

Table VI.9 shows the principal results furnished by the model, according to each option and on the basis of average and strong reactions by households to fiscal parameters. The results are presented in terms of impact on production, employment and economic loss attributable to the tax system. This concept of economic loss was explained in Chapter III and its value for the 1983 tax and transfer structure was also presented. The results in terms of income distribution and tax revenues will be shown in subsequent sections.

Given the characteristics of the reform options, it is useful to assess them by comparing, first, options I and II with the present state of affairs, and then option III with option II.

6.3.2.1 Comparison of options I and II with the present situation

It may be recalled that option I has the highest ordinary benefits, covering short and long-term essential needs, whether persons are available or not available for any type of reintegration process, and the highest transfer reduction rate, i.e. 67%. Option II is characterized by lower benefits, covering only short-term essential needs, and a distinctly more advantageous reduction rate, 50%.

The greater drop in the implicit marginal tax rates for low-income workers under option II to a great extent explains why this option succeeds in reducing economic loss due to taxes and transfers by about 6% for the whole labour force compared to a reduction of about 2% in option I (Table VI.9). The ensuing stronger incentive to work would lead to an increase in the number of hours worked equivalent, in option II, to the creation of between 38 000 and 58 000 full-time jobs, while option I would produce the equivalent of between 18 000 and 30 000 jobs, about half as many as option II.

In addition, although job creation is greater in these two options for low-income earners, the proportion of jobs created for low-income workers is distinctly more impressive in option II. When sensitivity estimates of strong reaction to fiscal parameters are used, the number of jobs created for poorly qualified manpower comes to a total of 57 000 while it is only 28 000 in option I. For manpower with average qualifications, option II makes it possible to maintain the employment level, roughly speaking, while option I means a loss of jobs. For highly qualified manpower, option I allows for creation of a greater number of jobs than option II.

Basically, although option I creates a certain number of jobs, option II offers a greater incentive to work and sets in motion a process by which firms are induced to hire more workers. The net domestic product goes up by 0.9% to 1.2%, depending upon the reaction hypothesis, an increase 50% higher than in option I.

Clearly then, from the point of view of economic efficiency and job creation, option II is distinctly superior to option I for the whole labour force and more specifically for manpower with poor and average qualifications. Economic efficiency is increased when, concurrently with the reduction in benefits, there is a reduction in the marginal transfer reduction rates to enable workers to keep a larger proportion of their work income.

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[4] HAUSSMAN, J., Massachusetts Institute of Technology.

6.3.2.2 Evaluation of option III

Option III consists in levying an additional $900 million by broadening the sales tax base to make possible greater achievement of the objectives of the reform, especially with respect to economic efficiency and the incentive to work. A greater emphasis on taxes on consumption as compared to taxes on production will have great repercussions on all levels — consumption, savings, and labour supply.

First, with regard to consumption and savings, the proposed broadening involves positive as well as negative structural effects. The positive effects stem from the increased savings formation that results from taxing consumption compared with taxing income; the increased savings are due to citizens' increased tendency to save when their consumption expenditures are taxed at a higher rate. The broadening of the sales tax base will also have the positive effect of decreasing distortions caused by unequal taxation of different consumer goods, thereby allowing an efficient allocation of resources by not favouring consumption of some exempted items to the detriment of others that are not.

Table VI.9

Economic impact of proposed reform options according to average or strong reactions by households[1]

Option	**I**	**II**	**III**
Changes in number of hours worked equivalent to full-time jobs			
— Total	17 900 to 29 900	38 000 to 58 000	47 800 to 72 500
— poorly qualified manpower	15 400 to 28 400	34 800 to 56 800	34 700 to 54 500
— manpower with average qualifications	– 1 400 to – 5 000	1 200 to – 1 000	8 300 to 11 000
— highly qualified manpower	4 000 to 6 500	1 900 to 2 100	4 900 to 7 100
Increase in net domestic product — in millions of 1980 dollars	300 to 450	470 to 640	790 to 1 160
— in % of net domestic product in 1983	0.6 to 0.8	0.9 to 1.2	1.4 to 2.1
Decrease in economic loss resulting from taxes and transfers — in millions of 1980 dollars	190 to 410	490 to 1 320	800 to 2 040
— in % of economic loss[2] in 1983	2.3 to 2.1	6.0 to 6.5	9.7 to 10.1

[1] A (–) sign means an increase in economic loss. The first figure of the range corresponds to an average household reaction, the second to a strong reaction.

[2] The concept of economic loss is defined in section 3.3.2.3.

On the other hand, we must recognize that the abolition of current selective exemptions (on furniture, clothing, etc.) will most likely have a negative impact on the development of certain industrial sectors that are especially important to Québec. In this manner, gains in jobs created by increased sales in those sectors already taxed will thus be partly offset by eventual losses in those currently exempted.

With regard to the labour supply, the broadening of the sales tax may indirectly influence the financial incentive to work by reducing the purchasing power of one hour's wages. It is reasonable to assume, however, that the negative effect will be largely offset by the fact that the sales tax, unlike income tax, does not promote the underground economy and does not directly reduce the net financial reward of work. Moreover, the sales tax rate, unlike income tax, is constant rather than increasing with income. For all these reasons, the negative effect of the sales tax on the incentive to work is considerably less than that of income tax.

It cannot be stated a priori whether the positive economic effects of broadening the sales tax base are greater or smaller than the negative impact. However, if it is taken for granted that they are equivalent, it is interesting to examine the results shown in Table VI.9 to compare option III with option II.

Option III provides the same level of benefits as option II and maintains the transfer reduction rate at 50%. This additional $900 million reduces marginal income tax rates by an average of four percentage points. This distinction has a bearing on the economic impact.

In option III, the equivalent of jobs created, between 35 000 and 55 000 for poorly qualified workers, is similar to that in option II. But, since its effect is greater for other categories of workers, it is easily superior to option II in overall job creation. According to strong reaction sensitivities, option III produces the equivalent of 73 000 jobs as opposed to 58 000 for option II. In addition, comparison of the effects on domestic production as well as economic loss demonstrates the superiority of option III, with twice the efficiency of option II. The significant reduction in marginal income tax rates under option III is responsible for this situation.

In summary, option III has the greatest economic impact both in terms of economic efficiency and in terms of production and employment for workers with average and superior qualifications, while it has virtually the same impact on job creation among poorly qualified workers as option II. It thus seems that an increase in the sales tax base to increase the overall incentive to work would be beneficial, in the medium term, for the economy of Québec, the most significant gains being shown in the employment sector, while net domestic production could grow by as much as 2%, without considering the positive effects on workers' movements.

6.3.3 Impact compared by socio-economic category

It is interesting to examine the effects of the reform on labour supply in various types of households. These effects are illustrated by means of the job equivalent, for single persons, single-parent families and couples with or without children. Table VI.10 shows these results on the basis of average and strong reactions by households to fiscal parameters. The relative situation of each household is generally the same in the two cases, the second simply amplifying the effects. In certain cases, however, the direction of the effect may be reversed when the income effect (lower tax rates and (or) higher non-availability benefits) becomes more significant than the substitution effect (lower implicit marginal tax rates). Note that the results presented here for single-parent families are estimated on the basis of assumption A (section 7.4.3) in which the essential needs of the first child equal those of the first child of a two-parent family and in which a special allowance for child care is granted.

It can be observed from the table that on the whole the reform creates as many jobs among single persons as among single-parent families and couples, with or without children. Under option II and III and according to the various sensitivity estimates of household reaction, the results indicate a job creation equivalent varying between 6 000 and 25 000 for single persons, between 13 000 and 23 000 for single-parent families and between 18 000 and 24 000 for couples, including the effects on the two spouses. It can also be observed that comparisons of employment for the whole labour force are also valid by socioeconomic category.

Tables VI.9 and VI.10 show that the objectives of economic efficiency and incentive to work are achieved at different levels depending on the reform option. It is also interesting to assess, with Table VI.11, the extent to which the reform favours the entry of the second spouse onto the labour market.

Note that, under the hypothesis of an average reaction of households to the changes in the tax and transfer systems, there is almost no difference, under the three options, in the incentive for the second spouse to enter the labour market. Under the hypothesis of a strong labour supply reaction, option I offers by far the greatest incentive for the second spouse to work. Option III leads to the smallest increase in employment for the second spouse. This situation stems from a sensitivity to implicit marginal tax rates that is much stronger among single persons and single-parent families than for couples. Conversely, couples will be much more sensitive to changes in their disposable income, so that the gains offered by option III in terms of disposable income will quickly offset the positive effects on their labour supply produced by a reduction in the **marginal tax rates**. The result is a substitution effect for couples which induces the least qualified of the two partners to reduce his participation in the labour market when disposable household income increases.

Table VI.10

Economic impact of options on the labour supply expressed as full-time job equivalents according to average or strong reaction of households
(Number of full-time jobs per category of household[1])

		Option	
	I	**II**	**III**
Single persons	2 300 to 10 600	6 100 to 17 700	10 300 to 25 200
Single-parent families	8 200 to 11 600	13 300 to 21 400	14 200 to 22 600
Couples with or without children	6 600 to 7 900	17 500 to 18 900	22 400 to 24 400

1. The first number in the range corresponds to an average household reaction, the second to a strong reaction.

Table VI.11

Impact of reform options on labour supply of second spouse expressed as full-time job equivalents according to average or strong reaction of households

		Option	
	I	**II**	**III**
Number of full-time jobs[1]	9 400 to 15 800	9 100 to 7 400	7 900 to 2 900

1. The first number in the range corresponds to an average household reaction, the second to a strong reaction.

6.4 Impact on Distribution of Income

The effects of the reform on income distribution may be examined in two manners. First, we may look at the variation in the net contribution to government financing before and after the reform for some typical households to determine the effect of the reform on the progressivity of the tax and transfer system. Second, we may look at how the reform could affect or modify the level of disposable household income ranked by decile of income.

Table VI.12 shows the variation in the net contribution to the State between $0 and $75 000 before and after the reform. The change in the **degrees of progressivity** that result are calculated as being this variation in the net contribution (between $0 and $75 000) as a percentage of the variation observed in the present system. If we compare the level of the net contribution of a person without employment income and not available for reintegration activities with that of a taxpayer earning $75 000, the differential under option III, as can be seen, is reduced by about 9% if he is married and has two children under six, and 8% if he is single. The proposed system would therefore be less progressive than it is at present.

The differential in net contribution to government expenditure between the taxpayer earning $75 000 and a person who is available for participation in community programs is reduced by about 4% under option III whether he is single or married with two children. Option III therefore reduces the degree of progressivity the most. The other options allow for reductions of between 1 and 3% according to the cases shown in Table VI.12.

On the other hand, Tables VI.13 and VI.14 show, in greater detail, how consumption taxes and property taxes are affected by the reform. In all the options, in fact, including option III where the sales tax is broadened, the sales tax credit improves the progressivity of this tax, since under $20 000 in income for a family with two children, less sales tax will be paid than under the present system while this broadened sales tax will hit such a family earning over $20 000. The new property tax credit improves the situation of such a family earning less than $10 000. Above this income level, the system of personal exemptions allows these families, which must themselves support their property tax burden, to reduce their taxable income by an amount equal to the needs covered under the income guarantee program.

The static approach we have just used has the drawback of not taking account of people's reaction to changes in their environment. One might conclude, for example, that the reform had the effect of decreasing the income of some low-income taxpayers, that it increased the income of all middle or high-income taxpayers and that this is unacceptable in a society which sought greater equality among people.

It is preferable to use a more dynamic approach to assess the impact of the tax and transfer system on income distribution which takes into account the changes to be expected in household behaviour. To this effect, it is possible to employ the **numerical general equilibrium model** used to estimate the economic effects of the various options. Certain adjustments, however, have been made to the model to take into account the size of the household when determining income distribution among different types of household.

In section 3.5, households were classified by decile according to income only, not taking into account the size of the households. Now, it is obvious that a single person with a disposable income of $20 000 enjoys a better standard of living than a couple with two children which earns the same income. The standard of living of each member of such a household however is greater than their *per capita* income, i.e. $5 000, because of the economies of scale involved in living together. That is why, to obtain an income equivalent, in terms of well-being, to that of a single person, thus allowing for a comparison of the income of different sized, households, family income must be adjusted by means of a series of indices based on the essential needs of different sized families. A scale of equivalence that reflects the changes in the level of essential needs as household size increases (as recognized by the taxation system) has been used.[5]

Table VI.15 shows these results according to disposable income per household as well as the scale of equivalence.

From this table, it can be seen that the distribution of income is more uniform when the number of persons in a household is taken into account, as is the case when the scale of equivalence is used. This means that there are relatively more low incomes

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5. In this scale of equivalence, family income was adjusted downward by a coefficient of 1.6 for a household consisting of two persons, by 1.9 for one composed of three persons and by 2.2 for one made up of four persons.

in single person households and a large concentration of high incomes in families with several children. Transfer payments also play a part in this result since they are often linked to family size.

However, these results cannot be compared with those given in Chapter III (Table III.21) because persons 65 and over, who constitute a good proportion of low-income earners, are not included in the population considered in the model.

The distribution of disposable income by decile with the scale of equivalence is the point of reference for the analysis of the redistributive effects of the different options proposed by the reform. The variations in disposable income held by each decile can then be evaluated from the numerical general equilibrium model, which enables us to determine whether it is the disposable income of the poorest or of the richest which will increase or decrease according to the adjustments in the behaviour of households as predicted by the model.

However, a distinction must be made between the decrease or increase in disposable income of households in a decile and the decrease or increase in the share of total income held by this decile, since a household may change deciles as a result of the reform. In analysing the effect on income distribution, at least two questions arise. First, at what point does the reform improve the economic situation of present deciles? Tables VI.16 and VI.17 try to answer this question by presenting the change in disposable income of each decile in millions of dollars and in percentage of disposable income held by households in this decile before the reform. Second, will income distribution after the reform be more or less the same as before? Table VI.18 deals with this question by showing the change in a synthetic index of income distribution, that is, the Gini ratio (this ratio was defined in section 3.5.3).

First may be considered the results directly stemming from the model, which however do not take into account the benefits paid to those participating in community or training activities. This is shown in Table VI.16. It appears that whatever the option or hypothesis of household reaction is, the second decile benefits from the greatest percentage rise in its disposable income. In fact, while the ninth and tenth deciles obtain the greatest increases in their disposable income in millions of dollars, this represents a lower proportion of their present income.

Nevertheless, the preceding results do not take into consideration the hundreds of millions of dollars allocated to the community and training programs. By comparing the percentage increases in disposable income held by the households in each decile as shown in Table VI.16, with those shown in Table VI.17, it is observed that these programs will benefit only the first five deciles, the second, third and fourth in particular. The first decile is less affected by these programs since over 80% of it is made up of single persons between 18 and 20.

From Table VI.17 it is clear that irrespective of the option or household reaction to the new fiscal environment, with few exceptions all deciles come out with higher disposable incomes after the reform.

It can also be seen that the second decile has the greatest improvement in its relative economic situation, followed by the third, then the fourth, and so on; this is true for all the reform options. The reform thus improves the income of the poorest more than that of the well-to-do, although it has little effect on the lot of the first decile. It should also be stressed that option III increases disposable income most for all deciles, even though it offers ordinary benefits which are lower than option I, except for the second decile, which is better off under option II.

Table VI.18 makes it possible to compare in synthetic fashion the degree to which the objective of income redistribution is attained in each option, while also taking into account the amounts distributed under labour market reintegration programs. The most important point to be stressed involves the reasoning that by giving more money to the disadvantaged and taxing higher incomes a fairer income distribution is achieved. Such an argument neglects the dynamic aspects underlying any tax structure. People adapt to this new fiscal environment and their employment income, the determining factor in income distribution, may increase substantially if the tax system offers a financial incentive. Table VI.18 provides a good illustration of these phenomena when household reaction to fiscal parameters is taken into account. It can be seen that all the options make possible a more egalitarian income distribution, as shown by the lower value of the Gini ratio. In addition, option II, with a low transfer reduction rate, improves income distribution more than the option with the highest ordinary benefits, option I. In one case the Gini ratio drops by between 0.009 and 0.010 (option I), in the other by between 0.011 and 0.015 (option II). For comparison purposes, let us recall that income distribution in Canada became less egalitarian between 1961 and 1971; during this period the Gini ratio associated with income

Table VI.12

Variation in net contribution[1] to financing of the state
Present situation and by option
(in 1983 dollars)

	Net contribution to government financing			
	Present system	**Option I**	**Option II**	**Option III**
Single person 30-64 living alone				
— No employment income	−4 466			
• Not available		−4 198	−3 397	−3 428
• Active 20 hours[2]		−5 124	−4 812	−4 824
— Income of 75 000 $	36 233	35 189	35 282	34 106
— Difference in relation to no employment income	40 699			
• Not available				
• in $		39 387	38 679	37 534
• in % of present system		96,8	95,0	92,2
• Active				
• in $		40 313	40 094	38 930
• in % of present system		99,1	98,5	95,7
Couple with two children between 6 and 11 one spouse working				
— No employment income	−9 482			
• Not available		−9 649	−7 623	−7 763
• Active 30 hours[2]		−10 549	−9 665	−9 770
— Income of 75 000 $	34 124	32 583	32 682	31 947
— Difference in relation to no employment income	43 606			
• Not available				
• in $		42 232	40 305	39 710
• in % of present system		96,8	92,4	91,1
• Active				
• in $		43 132	42 347	41 717
• in % of present system		98,9	97,1	95,7

1. A (−) sign means the taxpayer receives more in transfers from the State than he pays in various taxes and contributions.

2. Participating 20 hours a week in community activities in the case of single persons and 30 hours in a case of families with children.

Table VI.13

Impact of reform options on sales tax after credit, by level of employment income
Couple with two children under 12[1], one spouse working
1983 taxation year
(in dollars)

	Household employment income				
	0	**5 000**	**10 000**	**12 000**	**15 000**
Present system	520	565	628	673	715
Option I					
Taxes	507	585	661	698	719
Tax credit	– 160	– 160	– 160	– 160	– 140
Net taxes	347	425	501	538	579
Change[2]	– 173	– 140	– 127	– 135	– 136
Option II					
Taxes	411	523	633	679	721
Tax credit	– 160	– 160	– 160	– 160	– 157
Net taxes	251	363	473	519	565
Change[2]	– 269	– 202	– 155	– 154	– 150
Option III					
Taxes	506	659	810	873	933
Tax credit	– 400	– 400	– 400	– 400	– 399
Net taxes	106	259	410	473	534
Change[2]	– 414	– 306	– 218	– 200	– 181

1. The numbers shown apply more specifically to households with two children between two and six. With respect to children under two, or six years of age or over, the addition or subtraction of the availability allowance under the proposed or current system has a negligible impact on these results.

2. In relation to the consumption tax burden observed in present system.

distribution increased by 0.030. Implementation of option III would compensate for one half of this deterioration in the space of about five years.

The proposed reform appears beneficial in its dynamic effects from several points of view. It offers a strong incentive to work and increased economic efficiency, as well as improving income distribution, objectives which are frequently placed in opposition to one another. Although option II fosters the most egalitarian income distribution, and option III promotes the greatest economic efficiency, it is remarkable that in no case is this done to the detriment of other objectives.

Table VI.13 (continued)

Impact of reform options on sales tax after credit, by level of employment income
Couple with two children under 12[1], one spouse working
1983 taxation year
(in dollars)

17 000	20 000	25 000	30 000	40 000	50 000	60 000	75 000
762	829	936	1 019	1 153	1 278	1 359	1 555
771	838	946	1 031	1 169	1 283	1 369	1 595
−82	0	0	0	0	0	0	0
689	838	946	1 031	1 169	1 283	1 369	1 595
−73	9	10	12	16	5	10	40
775	842	949	1 032	1 168	1 281	1 365	1 591
−99	−12	0	0	0	0	0	0
676	830	949	1 032	1 168	1 281	1 365	1 591
−86	1	13	13	15	3	6	36
1 013	1 117	1 269	1 415	1 615	1 797	1 960	2 311
−341	−254	−104	0	0	0	0	0
672	862	1 164	1 415	1 615	1 797	1 960	2 311
−90	33	228	396	462	519	601	756

[1] The numbers shown apply more specifically to households with two children between two and six. With respect to children under two, or six years of age or over, the addition or subtraction of the availability allowance under the proposed or current system has a negligible impact on these results.

Table VI.14

Impact of reform options on property taxes after credit by level of employment income
Couple with two children under 12[1], one spouse working
1983 taxation year
(in dollars)

	Household employment income				
	0	**5 000**	**10 000**	**12 000**	**15 000**
Present system					
Taxes	517	567	639	690	739
Tax credit	−207	−227	−255	−238	−204
Net taxes	310	340	384	452	535
Option I					
Taxes	501	590	677	719	743
Tax credit	−501	−381	−237	−182	−68
Net taxes	0	209	440	537	675
Change[2]	−310	−131	56	85	140
Option II					
Taxes	391	520	645	697	747
Tax credit	−391	−363	−229	−179	−85
Net taxes	0	157	416	518	662
Change[2]	−310	−183	32	66	127
Option III					
Taxes	395	525	650	701	752
Tax credit	−395	−363	−231	−181	−89
Net taxes	0	162	419	521	663
Change[2]	−310	−178	35	69	128

1. The numbers shown apply more specifically to households with two children between two and six. With respect to children under two, or six years of age or over, the addition or subtraction of the availability allowance under the proposed or current system has a negligible impact on these results.
2. In relation to the property tax burden in present system.

Table VI.14 (continued)

Impact of reform options on property taxes after credit by level of employment income
Couple with two children under 12[1], one spouse working

1983 taxation year
(in dollars)

17 000	20 000	25 000	30 000	40 000	50 000	60 000	75 000
794	873	1 000	1 100	1 263	1 416	1 519	1 755
−190	−167	−128	−38	—	—	—	—
604	706	872	1 062	1 263	1 416	1 519	1 755
804	884	1 011	1 113	1 282	1 423	1 531	1 802
−54	−28	0	0	0	0	0	0
750	856	1 011	1 113	1 282	1 423	1 531	1 802
146	150	139	51	19	7	12	47
809	888	1 015	1 115	1 280	1 420	1 527	1 798
−67	−41	0	0	0	0	0	0
742	847	1 015	1 115	1 280	1 420	1 527	1 798
138	141	143	53	17	4	8	43
818	901	1 024	1 142	1 303	1 449	1 581	1 863
−72	−47	0	0	0	0	0	0
746	854	1 024	1 142	1 303	1 449	1 581	1 863
142	148	152	80	40	33	62	108

[1] The numbers shown apply more specifically to households with two children between two and six. With respect to children under two, or six years of age or over, the addition or subtraction of the availability allowance under the proposed or current system has a negligible impact on these results.

Table VI.15

Distribution of disposable income by decile
Simulation for 1983 according to average reaction by households
(in millions of 1980 dollars)

Decile of income (from the lowest to the highest)	**Distribution by household**		**Distribution according to scale of equivalence**	
	Total amount	**Share (in%)**	**Total amount**	**Share (in %)**
First decile	1 012	3,3	1 516	5,0
Second decile	1 139	3,8	1 809	6,0
Third decile	1 307	4,3	2 044	6,7
Fourth decile	1 861	6,1	2 172	7,2
Fifth decile	2 781	9,2	2 604	8,6
Sixth decile	2 988	9,9	3 252	10,7
Seventh decile	3 844	12,7	3 252	10,7
Eighth decile	4 235	14,0	3 643	12,0
Ninth decile	4 582	15,1	4 796	15,8
Tenth decile	6 544	21,6	5 205	17,2
Total	**30 293**	**100,0**	**30 293**	**100,0**
Gini ratio	0,315		0,221	

1. The numerical general equilibrium model of the Québec economy was used to simulate the distribution of disposable income in 1983. To do so, the 1983 tax structure was applied to the 1980 structure of households under the age of 65, grouped in 34 categories according to age and civil status. A new equilibrium was established according to assumptions about "average" or "strong" reactions to the new fiscal parameters of 1983; the distribution of income in 1983 shown in the table is based on this new equilibrium. Here, only the equilibrium under the average assumption is shown, the percentage distribution at equilibrium differing little from that under the assumption of strong household reaction.

Table VI.16

Increase in disposable income held by households in each decile by reform option according to average and strong reaction by households
(excluding effects of community activity and training programs)

	In millions of 1980 dollars		
Option	**I**	**II**	**III**
Decile:			
First	11 to 53	15 to 61	−7 to 57
Second	74 to 82	106 to 123	100 to 129
Third	−34 to −11	−56 to 3	−57 to 15
Fourth	11 to 2	−26 to −8	−31 to −2
Fifth	1 to 11	3 to 12	27 to 61
Sixth	29 to 42	55 to 65	114 to 148
Seventh	16 to 27	53 to 67	79 to 107
Eighth	18 to 30	56 to 70	81 to 110
Ninth	67 to 88	108 to 123	193 to 225
Tenth	74 to 104	117 to 130	212 to 235

N.S.: Not significant.

	In % of disposable income		
Option	**I**	**II**	**III**
Decile:			
First	0,8 to 3,4	1,1 to 3,9	−0,5 to 3,6
Second	4,0 to 4,6	5,7 to 6,9	5,4 to 7,2
Third	−1,7 to −0,6	−2,7 to 0,2	−2,8 to 0,7
Fourth	0,5 to 0,1	−1,2 to −0,4	−1,4 to −0,1
Fifth	N.S. to 0,4	0,1 to 0,4	0,9 to 2,2
Sixth	0,7 to 1,1	1,4 to 1,6	2,9 to 3,7
Seventh	0,5 to 0,8	1,6 to 2,1	2,4 to 3,3
Eighth	0,5 to 0,9	1,7 to 2,1	2,5 to 3,4
Ninth	1,5 to 1,9	2,4 to 2,7	4,2 to 5,0
Tenth	1,5 to 2,1	2,4 to 2,7	4,3 to 4,8

Table VI.17

Increase in disposable income held by households in each decile by reform option according to average or strong reaction by households including community activity and training programs
(in percentage of disposable income held in 1983)

	Reform option		
	I	II	III
Decile:			
First	2,8 to 5,2	3,1 to 5,7	1,5 to 5,4
Second	9,9 to 10,6	12,7 to 14,1	12,4 to 14,4
Third	5,8 to 7,1	9,4 to 12,4	9,3 to 13,0
Fourth	2,8 to 2,5	3,9 to 4,8	3,7 to 5,1
Fifth	1,2 to 1,6	2,4 to 2,8	3,3 to 4,6
Sixth	0,7 to 1,1	1,4 to 1,6	2,9 to 3,7
Seventh	0,5 to 0,8	1,6 to 2,1	2,4 to 3,3
Eighth	0,5 to 0,9	1,7 to 2,1	2,5 to 3,4
Ninth	1,5 to 1,9	2,4 to 2,7	4,2 to 5,0
Tenth	1,5 to 2,1	2,4 to 2,7	4,3 to 4,8

Table VI.18

Change in Gini ratio according to average of strong household reaction based on distribution of disposable income including community work and training programs according to scale of equivalence
Differential between 1983 reference and simulation

Household reaction	Option		
	I	II	III
Average	−0,009	−0,011	−0,006
Strong	−0,010	−0,015	−0,010

6.5 Financial Impact on Households and on the Government's Budget

In Chapter IV it was indicated that budgetary constraints restricted the Québec government's financial leeway for the full implementation of the reform of the tax and transfer systems to $600 million. In fact, the net total cost to the government of all the changes proposed for each of the options lies between $603 and $615 million if households do not alter their behaviour and do not react to changes in fiscal parameters. However, it should be noted that the estimates do not take account of the means of implementation; the cost considered is the cost in 1983 dollars when the reform is fully implemented. Taking account of the reaction of households to the new situation with respect to taxes and transfers as shown in section 6.3 on economic indicators, the total net cost of the reform to the government will be lower than this level in the medium term.

The impact of each of the proposed changes on Québec government finances may be divided into three main categories:

— *impact on various taxes.*

This represents the financial impact of changes in personal income tax and sales tax. Transfers which can be equated with taxes are included in this category: family allowances, the availability allowance and the property tax credit.

— *impact on transfers to individuals.*

These cover all the financial effects related to transfer programs for individuals, primarily social aid, which becomes the income guarantee program for persons able to work. The cost of this program covers ordinary and non-availability benefits, the employment income supplement, community activities and professional training, and child care subsidies. The impact also includes the secondary interaction effects of this reform with other transfer programs such as low rental housing costs.

— *impact on federal transfers.*

These result first from changes in shared cost programs. It is taken for granted that the federal government will accept the changes in social aid for those able to work; this will involve changes in the present rules of the public assistance program in Canada. In actual fact, there is no reason to doubt that an agreement can be made since the federal government has already approved the changes Québec presented under its recovery plan. However, if such agreement for a new division were not reached with the federal government, the impact of the reform on Québec's budget equilibrium would be greater. Lastly, certain changes in the Québec government's own-source revenues will modify the level of federal equalization transfers and this effect is included in the estimate of the impact on federal transfers.

Table VI.19 breaks down the manner in which the financial cushion of about $600 million which is needed to fully implement the reform will be used by the government. In options II and III a greater part is used to lighten the tax burden of taxpayers while in option I transfers to individuals take up a greater portion of this leeway.

The level of the impact on federal transfers differs from one option to another given the difference in the level of transfer expenditures shared by the federal government, that is, the changes in the social aid program and the creation of the new income guarantee program. In option I federal transfers would increase by nearly $300 million while in options II and III the increase would be close to $200 million.

This increase in federal transfers would be injected into the reform to further improve the tax situation of households. Personal disposable income would go up by the equivalent of the sum of the amount of financial leeway used and the impact on federal transfers: by between $770 million in option II and $875 million in option I.

In Table VI.20 a breakdown is given of the impact of the reform on the disposable income of households by group of taxpayer and level of income. The data used were taken from the files of the ministère du Revenu. Since the department's files do not enable one to associate all persons with the households to which they belong, the average incomes shown in the table are underestimated. For example, although in general, in surveys on family income, a single person who remains with his parents is regarded as being part of a family group, this person is not included in the household in tax statistics if he has filed a tax return. Only couples and children under 18 are included in households for these purposes. The data must therefore be interpreted with caution.

It can be seen that in all the options at least half of the $800 to $900 million paid out to individuals under the reform goes to households whose in-

Table VI.19

Impact of the reform options on the after tax income of Québec households (consistent behaviour), and on the financial balance of the gouvernement du Québec
Full 1983 taxation year
(in millions of dollars)

	Option I	**Option II**	**Option III**
Impact on households[1]			
Changes in taxes			
— Personal income tax	315	395	1 318
— Consumption taxes	—	—	(936)
— Total impact on changes in taxes	315	395	382
Changes in transfers to individuals	560	375	412
Net impact on after-tax income of households	875	770	794
Impact on the financial balance of the government[2]			
Changes in personal taxation amd transfers	(875)	(770)	(794)
Impact on federal transfers	260	167	189
Net impact on the financial balance of the government	(615)	(603)	(605)

1. For households, a figure within parentheses means an increase in taxes or a reduction in benefits.

2. For the government, a figure between parentheses means a drop in revenue or an increase in transfers to individuals.

come is less than $15 000. When we consider that 49% of the households listed in the file have an income of less than $15 000 the reform seems very much more balanced. It is option III which favours this income group the least, since 53% of the benefits are allocated to it.

Table VI.20

Impact of the proposed options on different types of households
(in millions of dollars)

Household	**Single persons**	**Single-parent families**	**Childless couples**	**Couples with children**	**Elderly persons**	**Total**
Households currently receiving social-aid benefits						
• Option I	(12)	78	21	69	—	156
• Option II	(36)	60	15	66	—	105
• Option III	(41)	60	14	73	—	106
Number of households concerned	247 800	78 705	22 930	45 690	—	395 125
Households with income of less than 15 000 $						
• Option I	338	8	29	50	7	432
• Option II	270	5	27	33	9	344
• Option III	245	10	15	42	1	313
Number of households concerned	655 900	54 995	63 170	87 110	221 800	1 082 975
Households with income of between 15 000 $ and 30 000 $						
• Option I	(3)	(6)	36	91	5	123
• Option II	5	(5)	48	112	9	169
• Option III	18	(7)	33	87	—	131
Number of households concerned	326 200	38 000	158 400	306 000	68 400	897 000
Households with income between 30 000 $ and 50 000 $						
• Option I	1	(2)	18	70	1	88
• Option II	(2)	(2)	20	73	1	90
• Option III	17	(1)	29	69	1	115
Number of households concerned	68 000	9 500	128 300	275 700	16 200	497 700
Households with income of over 50 000 $						
• Option I	6	1	19	51	3	80
• Option II	5	1	15	42	2	65
• Option III	14	2	45	60	9	130
Number of households concerned	11 500	1 900	44 300	99 300	11 500	168 500
All households						
• Option I	330	79	123	330	15	875
• Option II	241	59	125	327	21	770
• Option III	252	63	138	331	11	794
Number of households concerned	1 309 400	183 100	417 100	813 800	317 900	3 041 300

Note: Because of rounding, totals may not equal the sum of their figures.

Among households whose estimated income is between $15 000 and $50 000, the amounts paid out are also relatively large, varying between $211 million and $259 million. For those above the $50 000 level, the amounts involved are smaller. They reach their maximum in option III with $130 million. In the other options, the amount paid out to households whose income exceeds $50 000 is somewhere between $65 million and $80 million.

If we examine instead the amounts paid out by category of taxpayer, we see that couples with children, with both spouses working, receive a larger amount under the reform, over $300 million. They are followed by single persons who are not part of a couple and have no dependent children; they receive about $300 million. It must be noted however that this category of taxpayer is a large one. Single-parent households receive less per family; this could be increased, as is explained in the next chapter. Finally, elderly persons are more or less unaffected by the reform as was explained earlier.

For a better understanding of the effects of the various proposals, Table VI.21 presents a breakdown of the financial impact for each of the elements of the reform. It can be seen that some of the major elements of the reform are the changes in tax rates. These take into account the introduction of a lump-sum income tax reduction which, as we have seen, will compensate for the reduction in personal exemptions. Even though the basic personal exemption will be less than it is at present — bringing in from $389 million to $440 million depending upon the option — this is more than offset by the introduction of a lump-sum reduction in income tax which could cost the government between $700 million and $900 million, depending on the option; this great difference with respect to the total reduction in income tax is the result of the orientation proposed in each option. For example, in option III, the increase in the sales tax base, which will increase government revenues by over $900 million, will make it possible to finance the large reduction in personal income tax.

Another important effect arises from the changes in transfers to individuals. When the reform is fully implemented, the reduction in the ordinary and non-availability benefits for households which are recipients under the income guarantee program, will represent a drop in government spending of about $300 million, in 1983 dollars, under options II and III, taking account of the property tax credit and the sales tax credit. But this decrease in government expenditure is more than offset by the decrease in the transfer reduction rate and the level of financing for labour market reintegration programs. This change, in relation to the present employment income supplement, is equivalent to an additional expenditure for the government of between $650 million and $700 million, depending on the option selected. Overall, then, the new income guarantee program would cost between $400 million and $600 million more than under the present transfer system for those able to work. However, it should be noted that, as part of the recovery program, an amount of $133 million has been provided for the supplement for reintegration activities in 1985-1986. The net cost of the income guarantee program would be reduced by an equivalent amount since the cost of the recovery program has not been included in the assessment of costs we have presented here.

Therefore, the effect on the Québec government's revenue of the full implementation of any one of the options would amount to the net use of a financial leeway of some $600 million in 1983 if all the changes were implemented. However, the budgetary impact of the reform has so far been quantified without taking account of the positive effects on the incentive to work and produce and, as a result, on the Québec government's financial framework or that of the federal government. The numerical model makes it possible for us to evaluate, in 1983 dollars, what the tax revenues generated annually by increased economic activity will come to when households will have adjusted to the changes in the tax and transfer systems.

The increase in employment and in production will have a positive impact on tax receipts derived from income tax, consumption taxes, taxes on corporate profits, etc., and will reduce transfers to individuals paid by both the federal and Québec governments. Table VI.22 provides an estimate of the tax receipts and reductions in transfers for both governments by taking into consideration the intensity of the reaction of households to the tax changes. There is obviously no question of an increase in the personal tax burden since taxation rates and the rate of reduction in transfers are specifically laid down by the reform options. It is rather a matter of lower transfer payments and higher tax revenues from higher levels of employment income, consumption expenditures, as well as production which would affect the government's budget.

Table VI.21

Estimated financial impact of tax and transfer changes proposed in each of the reform options
Complete 1983 taxation year
(in millions of dollars)

		Option I	Option II	Option III
A. Impact on disposable household income[1]				
1. Changes in income tax				
1.1 Changes in taxable income				
1.1.1	Change in level of basic personal exemption	(440,3)	(440,3)	(388,6)
1.1.2	Change in level of married person's exemption and abolition of maximum level of spouse's income	68,2	68,2	80,9
1.1.3*	Change in level of exemption for dependent children 16 and over and introduction of exemption for dependent children under 16	399,8	399,8	409,6
1.1.4	Abolition of age exemption for persons 65 or over who remain active in the labour market	(15,8)	(15,8)	(15,8)
1.1.5	Abolition of married person's equivalent	(65,9)	(65,9)	(65,9)
1.1.6	Change in level of exemption for other dependents	15,8	15,8	16,3
1.1.7*	Taxation of federal family allowances (including abolition of graduated scale)	(127,3)	(127,3)	(127,3)
1.1.8	Change in employment expense deduction	129,3	129,3	129,3
1.1.9	Abolition of the general deduction of 100 $	(35,9)	(35,9)	(35,9)
1.1.10	Introduction of a property tax deduction	165,4	165,4	165,4
1.1.11	Interaction of various measures	(32,5)	(32,5)	(34,0)
1.1.12	Total impact of changes in disposable income	60,9	60,9	134,0
1.2 Changes in tax rates				
1.2.1	Change in the tax table	(36,5)	(116,9)	775,4
1.2.2	Abolition of the general 3% reduction	(203,6)	(203,6)	(203,6)
1.2.3	Introduction of an income tax reduction	731,8	886,7	684,1
1.2.4	Total impact of changes in income tax calculation	491,7	566,2	1 255,9
1.3 Changes in tax credits				
1.3.1*	Abolition of provincial family allowances	(182,0)	(182,0)	(182,0)
1.3.2	Abolition of availability allowance for children 2 or over	(78,0)	(78,0)	(78,0)
1.3.3	Introduction of a sales tax credit	100,5	103,5	315,2
1.3.4	Abolition of present property tax refund	(120,4)	(120,4)	(120,4)
1.3.5	Introduction of a property tax credit	51,2	53,3	53,6
1.3.6	Withdrawal of part of consumption tax credit taken into account in transfers	(35,0)	(35,0)	(86,7)
1.3.7	Total impact of changes in tax credits	(263,7)	(258,6)	(98,3)

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[1] For households, a figure between parentheses means a reduction in disposable income; otherwise it means an increase.

* For illustrative purpose only, the table shows the impact of one of the basic choices involving single-parent families and dependent children (Chapter VII).

Table VI.21 (continued)

Estimated financial impact of tax and transfer changes proposed in each of the reform options
Complete 1983 taxation year
(in millions of dollars)

	Option I	**Option II**	**Option III**
1.4 Various measures not quantified by simulation model			
1.4.1 Abolition of exemption of initial 500 $ of income from scholarships and grants	(3.0)	(3.0)	(3.0)
1.4.2 Study expense deduction for taxpayer with dependent student	15.0	15.0	15.0
1.4.3 Net impact of system on child care expense deduction	101.1	101.1	90.3
1.4.4 Net impact of system on taxation of child care income	(86.7)	(86.7)	(75.9)
1.4.5 Impact on other measures	26.4	26.4	26.4
1.5 Total impact of changes in income tax	**315.3**	**394.9**	**1 318.0**
2. Changes in transfers to individuals			
2.1 Income guarantee program			
2.1.1 Ordinary and non-availability benefits	(201.8)	(399.7)	(425.6)
2.1.2 Property tax credit	70.2	70.2	70.2
2.1.3 Sales tax credits for recipients	23.9	23.9	60.0
2.1.4 Supplement			
— remuneration for community activities and training programs	282.9	454.4	454.4
— for employment income	381.2	254.7	254.7
2.1.5 Subtotal of transfer expenditures shared with the federal government	556.4	377.0	413.7
2.1.6 Child care subsidies for income guarantee program recipients	23.3	23.3	23.3
2.1.7 Child care subsidies for workers	32.5	27.5	27.5
2.1.8 Abolition of former employment income supplement	(22.5)	(22.5)	(22.5)
2.1.9 Subtotal: income guarantee program	589.7	404.8	442.0
2.2 Other transfers	(30.0)	(30.0)	(30.0)
2.3 Total impact of changes in transfers to individuals	**559.7**	**375.3**	**412.0**
3. Net impact on disposable income of households	**875.0**	**769.8**	**1 730.0**

Table VI.21 (continued)

Estimated financial impact of tax and transfer changes proposed in each of the reform options
Complete 1983 taxation year
(in millions of dollars)

	Option I	Option II	Option III
B. Impact on the tax burden of households[2]			
Change in personal income tax and transfers	(875,0)	(769,8)	(1 730,0)
Change in consumption taxes	—	—	936,0
Impact on the tax burden of households[2]	**(875,0)**	**(769,8)**	**(794,0)**
C. Impact on the financial balance of the government[3]			
Change in personal taxation and transfers	(875,0)	(769,8)	(794,0)
Impact on federal transfers			
— shared expenditures	278,2	188,5	206,9
— equalization	(18,8)	(21,8)	(18,0)
— net impact on federal transfers	259,4	166,7	188,9
Impact on the financial framework of the Québec government	**(615,6)**	**(603,1)**	**(605,1)**

[2] For households, a number in parentheses means a reduction in the tax burden; otherwise, an increase.

[3] For the government, a figure between parentheses means a cost; otherwise, a gain.

Depending on the option chosen and the strength of the reaction of the households studied in the general equilibrium numerical model, the indirect effect of the reform will be to increase own-source income and reduce the federal and Québec governments' transfers to individuals compared with that observed before the reform has been fully implemented, by an amount somewhere between $180 million and $880 million.

The medium-term self-financing capacity of a major tax reform constitutes another criterion for assessing the options of the proposed reform. One of the indicators of increased economic activity through the application of a given reform option is certainly its capacity for indirectly generating net tax revenues. This capacity also shows how realistic it would be to implement this particular option. From this point of view option III is clearly the most promising with regard to increasing the net tax revenues of both governments — by an amount somewhere between $473 million and $788 million.

However, the greater part of these benefits would accrue to the federal government. On the one hand, more vigorous growth in Québec's economy would increase federal tax receipts. On the other hand, the increase in Québec's own-source income as a result of that same economic growth would reduce federal transfer payments and funding of established programs. In addition, the drop in the cost of the income guarantee program would reduce federal transfers under the Canada Assistance Plan. It is thus estimated that half of the gross effect of the reform on the gouvernement du Québec's own-source income and on transfers to individuals as a result of the Québec economy's more vigorous growth would accrue to the federal government through reduced transfer payments to the gouvernement du Québec. This means that, overall, once general equiblibrium is reached, the Québec government could recover, each year, something between $250 million and $350 million of its initial investment under option III, and between $100 million and $200 under option II, without placing individuals at a disadvantage. The remainder would go the federal government and would more than offset the apparent short-term cost of the increases in transfers to the Québec government within the framework of the new income guarantee program.

Before making definite choices and determining the rate of their implementation, it is essential to decide exactly how the effects can be spread over the coming years. In particular, we must know whether the federal governement intends to modify the present fiscal arrangements so as to effect a more adequate balance of the tax benefits resulting from economic recovery initiatives on the part of the provincial governments.

Table VI.22

Estimate of the indirect impact of reform options on net tax revenues of the Québec and federal governments according to average or strong reactions by households[1]
(in millions of 1983 dollars)

Option	**Average reaction Impact (% self-financed)**		**Strong reaction**	
Option I	180	(20%)	380	(43%)
Option II	340	(44%)	580	(75%)
Option III	730	(92%)	880	(111%)

1. The percentage of the reform which is self-financed for the federal and Québec governments was estimated using the relation between the increase in net indirect tax receipts and the cost of implementing the reform according to the general equilibrium model. This rate was then applied to the cost to the federal and Québec governments of implementing the reform according to ministère des Finances estimates (see Table VI.21, line "Impact on the tax burden of households") in order to estimate the indirect impact of the reform options.

Basic Choices

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Basic Choices

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Chapter VII
Basic Choices

The reform of the personal tax and transfer systems is an undertaking whose objectives are of vital importance to Québec. As was noted in Part I of the *White Paper*, taxation and transfers affect the core of Québec society: redistribution of income, social justice, economic strength, methods of government financing, and so forth. Changes must be made at several levels; some of them are more technical in nature and will less directly affect individuals, while others are much more basic and hence likely to be contested, to a greater or lesser extent. A public debate is thus needed to arrive at a broad social consensus on most of these fundamental choices.

Chapter V outlined a series of measures put forward to attain these objectives. In this chapter, it is important to return to the main points. The basic choices confronting Québec society must be set out and elucidated.

The first choice concerns the taxation and transfer units under the proposed system. The next one is related to the essential needs which the new tax and transfer systems must recognize: first, the level of these needs then the manner in which they are covered in the transfer system, with or without the requirement that beneficiaries participate in activities to become reintegrated into the labour market. A third choice involves the treatment granted to the various categories of taxpayers.

The level of essential needs recognized by the new system also raises the question of integrating the various components of the tax and transfer systems, and the choice of a method for recognizing such needs under the tax system. In the latter instance, a further choice must be made between two main avenues: exemptions, or tax credits.

The importance of consumption taxes in the tax structure, that is, choosing between options I and II, on the one hand, and option III, on the other, is also included among the fundamental choices. Finally, the introduction of a minimum income tax in order to ensure that those with the ability to pay income tax do, in fact, contribute to financing government expenditures is an area of current concern which will have to be dealt with in the coming years by the various levels of government.

To conclude, an attempt will be made to clarify the choices society must make, and the option preferred by the government as the vehicle for attaining the reform's objectives will be identified.

7.1 Taxation and Transfer Units

The proposed options do not call into question the choices under the current system with respect to **taxation** and **transfer units***. The individual remains the taxation unit, and the family, the transfer unit.

Considering the family as the transfer unit is based, first and foremost, on the observation that the basic economic unit in our society, that is, the one in which economic decisions are made, is generally the family. Moreover, the cost to the government of a transfer system based on the individual (which ensures each individual a basic income, whether he is part of a family or not, and regardless of family income) would be prohibitive. In the case of option I, for example, it would cost the government about $3 billion in additional funds to defray the cost of the essential needs of all adults whose income is insufficient to cover them. To this would have to be added a further $2.7 billion if the essential needs of children were totally covered.

Given that families, not individuals, will ultimately be helped by the government when their resources are inadequate, the transfer unit selected leaves full responsibility for ensuring the essential needs of each of its members to the family. However, such a choice of transfer unit is less neutral with regard to the organization of the family than a unit based on the individual, as a person will no longer be entitled to government transfers when, for example, he marries someone who can provide for the needs of both. The first person would then be considered dependent on the second, rather than on the government. Or, if he decides to live with relatives, government assistance is reduced to reflect the fact that the relatives are contributing to his essential needs. This choice favours the establishment of single-parent families and households comprising single people all the more because of the concomitant high benefits. On the other hand, it is the only feasible solution, given the costs and the consequences implicit in choosing the individual as the transfer unit.

A second basic choice concerns the taxation unit, which may be based on the individual or the family. Depending on the case, it is the income of the individual, or the income of the family which is taxed. However, in the case of the individual unit, the essential needs of the individual's dependents are covered by personal exemptions, which reduce taxable income; this system is currently in effect in Québec, in Canada and in several other countries. Each taxation unit has advantages and disadvantages. Of the two, the family unit undoubtedly makes for the fairest tax system as it takes into account the family's ability to pay. However, such a system is the least neutral with regard to the organization of the family where both spouses work outside the home. However, it offers the least incentive to the second spouse to enter the labour market since the income of the second spouse is taxed at the same marginal rate as that of the first. The tax system using the individual as a unit is more neutral with regard to family organization and gives the second spouse a greater incentive to enter the labour market, but takes less account of the ability to pay. Choosing between these different taxation units entails choosing between fairness on the one hand, and neutrality and the incentive to work on the other.

In the proposed reform, we have decided to maintain a tax system based on the individual as the taxation unit. The current system is widely accepted in our society; it corresponds to trends noted elsewhere, and has the added advantage of aligning itself with the federal tax system.

The main disadvantage of a tax system based on the individual is that, for a given employment income, it favours couples where both spouses work over couples where only one spouse works. However the proposed reform reduces this disparity by making the spousal exemption identical to the basic personal exemption, and reducing progressive increments in the marginal tax rates.

However, choosing a transfer unit which is different from the taxation unit makes integrating the tax and transfer systems more complicated. A system of personal exemptions based on the level of essential needs recognized by the transfer system is therefore proposed with a view to taking into account essential needs, ensuring fairness under the taxation system, and integrating it with the transfer system.

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* Terms in boldface type are defined in the glossary.

7.2 Identification and Assessment of Essential Needs

Once it has been established that the transfer system will use the family as its basic unit, and that the individual will serve as the basic unit under the tax system, it is necessary to determine the level of essential needs which society deems minimal and which will be ensured by the transfer system.

In this regard, the proposed reform would base the level of essential needs on the expenses actually incurred by low-income earners to cover these needs. This initial choice is very decisive, and implies that the norms employed under the transfer system are affected by conditions prevailing on the job market. At the same time, it does include guarantees with regard to the incentive to work and fairness between workers and non-workers.

The second choice consists in deciding which group, among low-income earners, will serve as a reference. The proposed reform sets the level of transfers and personal exemptions on the basis of the average amount of expenditures of low-income households, namely those with incomes derived mainly from employment which were under \$13 700 in 1983. Incomes under \$13 700 are those of heads of household or spouses working full-time, who fall into the first income decile (first 10%). It would be possible to conceive of a level of guaranteed income higher than what the labour market offers such wage earners. However, in doing so, society would face considerable costs, financial as well as with respect to fairness, economic efficiency and the incentive to work.

The third choice concerns the consumer goods to be considered. Should the criteria selected encompass the essential and nonessential needs of these low-income households? If not, which ones? In this regard, it apears necessary to refer to the Social Aid Act, which breaks down needs into ordinary and special ones. The former include food, clothing, domestic and personal necessities and other expenses related to occupying a house or dwelling. The Act is fairly restrictive. Of course, such a notion may be open to interpretation. Under all the options of the reform, the notion proposed includes the following types of expenses, drawn from the inquiry into family expenses: food, housing (including heat and electricity), communications (telephone and mail), household services (household cleaning products and other articles), personal care (personal care products, equipment and services), clothing, and furniture and accessories. This definition is therefore broader than that in the Social Aid Act, since it includes furniture and accessories. It must be pointed out that options II and III do not cover these needs in the same way, as will be seen in the following section.

Definition of essential needs to be guaranteed by the government for households with insufficient income constitutes a social choice of great importance. It is a choice which affects, on the one hand, the degree of incentive to work in the economy, but which, above all, determines the standard of living of an appreciable fraction of the population, and its participation in collective wealth.

7.3 Ways of Covering Essential Needs

To varying degrees, depending on their wealth and their desire to redistribute income, modern societies have accepted the idea of ensuring a minimum income for all citizens, to cover their essential needs. Under the proposed reform, the conclusion was reached that this minimum should correspond to the expenses incurred by low-income households for the satisfation of a number of their needs which are deemed essential. Although this minimum coverage is widely accepted in principle, the point at which the government's responsibility to cover these needs ends and that of the individual begins is harder to determine.

The approach adopted by the reform consists in attributing part of this responsibility to families. The government will not have to ensure the essential needs of individuals belonging to families with sufficient financial resources to cover such needs (see section 7.1).

Among households with insufficient resources, the government's and beneficiaries' responsibilities are harder to delineate. The various options propose different levels of sharing. Under option I, the government would be entirely responsible for covering essential needs. Under the other options, essential needs overall are only ensured for those who are active. It is thus assumed to be incumbent upon individuals to partly assume the cost of their essential needs by working or, by participating in activities designed to enhance their "employability", which would ultimately enable them to obtain employment. Two cases must be distinguished among those who are not active in the labour market or do not participate in such activities. For recipients who are not available to participate in the labour market or for reintegration activities, the "safety net" ensured by the government would cover short-term essential needs; in many cases, this "safety net" corresponds roughly to what is paid in Ontario. Moreover, for those who are available, benefits would be maintained at its current level during the initial implementation of the reform until it reaches the level of short-term essential needs plus clothing requirements. Indeed, it seems important to cover the clothing needs of those who are available, all the more so as this need is already recognized in the existing Act.

The proposal defining a lower level of coverage of essential needs than under the current transfer system for those who are not available to participate in the labour market or for reintegration activities is, indeed, an important choice. This choice could not, however, be fully implemented until all recipients had been personally contacted and had, in fact, refused a job or a reintegration activity.

7.3.1 The implementation of options II and III

Although options II and III propose that beneficiaries ensure coverage of part of their essential needs through training or community work projects, it would be incumbent upon the individual to choose his own reintegration activity and find the programs available. Should he so desire, he could obtain advice in making a choice from various agents. However, this does not mean that the government would take the individual's place in defining and carrying out such activities. Moreover, it would be necessary to maintain a considerable financial advantage in order to facilitate a return to the job market, which is the only sure way of ensuring the beneficiary's financial independence in the medium term.

The introduction of an adequate range of programs to assist those who are available for reintegration activities will certainly mobilize considerable energies, although individuals are basically responsible for them.

Moreover, it is obvious that an approach which requires the participation of the individual in covering his essential needs, as is the case under options II and III, cannot be indiscriminately applied to all social aid recipients. It is for this reason that one of the fundamental choices under the proposed reform consists in establishing a distinct income guarantee program for those who are able to work, with requirements which are different from those under the social aid program, with emphasis placed on measures designed to foster reintegration into the job market. This new program would be open to persons between 21 and 64 who are able to work, or deemed temporarily unable to work. The social aid program would be restricted to persons considered unable to work.

The criterion of ability to work would become much more decisive under the new transfer system than at present, as the social aid program would only be available to those considered permanently unable to work. Under the current system, a doctor's certificate attesting to the individual's inability to work is sufficient for the individual to be classified in one category or another; the means must be found to reduce the risks of subjectivism and discretionary application of policies in this area. Thus, it will be necessary to establish special committees to assess beneficiaries' ability to work, as is the case with respect to the Québec Pension Plan, automobile insurance, health insurance and workmen's compensation. Such committees would endeavour to adopt the fairest, most objective and most uniform standards possible, with a view to determining eligibility for social aid or income guarantee program benefits.

Notwithstanding such norms, certain beneficiaries might be automatically considered unable to work under the new transfer system. On the other hand, they would be able to choose between the social aid program or the income guarantee program, whichever suits them the best. This situation would apply to the handicapped, to those over 60, or people over 50 for whom adding their age and the number of years of absence from the labour market totals more than 60.

The choice between an approach where the government is alone in guaranteeing the income necessary to satisfy the essential needs of people able to work (option I) and a more dynamic approach where the individual is called upon to participate in covering his essential needs (options II and III) is a crucial one. Québec society must decide which of these approaches is to be favoured under the reform of the transfer system during the coming years.

7.4 Treatment Accorded Various Categories of Households

The method of determining the level of essential needs for the overall population was outlined in section 7.2. To ensure fairness among the various categories of households, an equitable manner of determining such needs for each of the categories must be found.

For certain categories of households, the choices to be made are harder; here, it is important to emphasize the pros and cons of each option envisaged. These problems occur with regard to persons who are alone, according to the manner in which they occupy a dwelling, single-parent families, and those under 30.

7.4.1 Persons who live alone

The treatment accorded under the tax system to persons who are alone (single, widowed or divorced) raises three types of questions: those of fairness, administration and neutrality. Persons who group together into a household make savings in operating the household compared with those who live alone. In terms of fairness, it must be asked whether the additional cost of living alone in a dwelling constitutes a need recognized by society as an essential one, and whether it should be covered by the income guarantee program and taken into account in personal exemptions.

Up until now, the transfer system has recognized this need as an essential one, and has paid to persons living alone benefits equivalent to 60% of those paid to couples. This orientation would be preserved under the reform. The present tax system is ambiguous as it grants higher exemptions to couples when both spouses earn income ($10 060) than to couples with one work income ($8 800). Thus, the recognized needs of persons living alone equal 57% of those of couples in which one spouse works, but only 50% of those of couples in which both spouses work. The proposed reform eliminates this ambiguity by granting the same personal exemptions to both categories of couple, that is, $8 784 under options I and II.

Out of a concern for greater fairness, it is being proposed that individuals who are alone and who share a dwelling with other adults be granted benefits equal to 50% of those of a couple, rather than 60%. The same logic would apply with respect to personal exemptions. It will be necessary to find the means, administratively, of verifying the manner in which housing is occupied among all individuals who are alone. Obviously, this is easier when the tax and transfer systems are administered in an integrated fashion.

If we proceed in this manner, the administrative problems engendered by the principles already applied by the transfer system will spill over into the tax system. It is easier to verify who is single, widowed, divorced or married than to determine the manner in which a dwelling is occupied. Most people who are alone share their housing with others. Under the current social aid program, the government has surmounted the problem by granting reduced benefits to all unattached persons living with a relative. The administrative problem has been eliminated by granting the benefit to everybody, including those who, logically, are not entitled to it as they make the same savings as married people, or those living with their families.

Since the existing transfer system makes no distinction between a beneficiary living alone and living with others, it is to the beneficiary's advantage, financially, to share a dwelling. Under the new system, sharing a dwelling would reduce income guarantee program benefits by $700 on an annual basis, equivalent to the economies of scale effected in comparison with a person who lives alone. There will therefore be no financial incentive to choose one lifestyle over another; the choices made will necessarily be more suitable and more efficient. That is the advantage of a system which recognizes needs arising from the fact of living alone in a dwelling as being part of essential needs of those who in fact live alone.

7.4.2 Persons under 30

The current transfer system makes an important distinction with respect to the benefits paid to those 30 or over and those under 30, among people who are alone and childless couples. The difference in benefits, which can amount to $250 per month, is intended to give those under 30 a greater incentive to enter the labour market, and reduce the costs of the social aid program. The same age distinction does not apply to beneficiaries who are unable to work. The more limited potential for gain among recipients under 30 in relation to that of recipients 30 or over might justify, in part, such a disparity in benefits should we wish to provide a similar incentive to work in both cases.

Under the reform envisaged, this disparity is not called into question, as the reasons which led to its implementation are still valid. This choice implies that beneficiaries under 30 must themselves ensure a larger part of their essential needs. To facilitate their task, the reform proposes important improvements. First, they will be eligible for the same income guarantee program as other categories of beneficiaries. The advantage for them in working will be increased, and they will derive more income from such employment than is now the case. The same applies to the advantage in participating in activities designed to enhance their "employability". In the latter instance, however, the greatest part of the improvement arises from the special programs recently set up by the ministère de la Main-d'oeuvre et de la Sécurité du revenu and intended precisely for persons under 30. Even if, under the reform, these programs are open to persons 30 or over, priority of eligibility should be given to those under 30 who receive reduced benefits.

However, it should be remembered that, with respect to beneficiaries aged 18 to 20, the question of taking into account their parents' income when calculating their benefits has been raised, in order to better harmonize the student assistance program with the transfer system. The disposable income of recipients between 21 and 29 will, however, rise, following the change in the property tax refund, and the introduction of the sales tax credit.

7.4.3 Single-parent families

The application of the proposed reform as it pertains to single-parent families must be centred on the essential needs of these families and additional needs arising from employment. However, a choice will have to be made with respect to the level of essential needs to be recognized. This choice will have, on the one hand, an impact on the incentive of single-parent families to be financially independent and, on the other, the fairness and neutrality of the tax and transfer systems.

Under the present tax and transfer systems, the recognized essential needs of single-parent families with one child are the same as those of a childless couple. It is recognized that the first child in a single-parent family generates considerably greater expenses for essential needs than a couple's first child. The transfer system grants $1 139 more for the first child in a single-parent family without employment income than for that of a two-parent family (see Table VII.1). The tax system goes farther still, as the differential is $3 770 for a family earning income taxed at the maximum marginal rate. In fact, under the tax system, the recognized essential needs of a child under 6 in a single-parent family are now higher ($5 193) than those of a dependent spouse ($3 770). Recognition of such levels of essential needs for the first child of a single-parent family creates serious problems with regard to fairness and neutrality, as was noted in Chapters II and III.

Two assumptions may be made with a view to helping structure the discussion and to illustrate the implications of the possible choices, which consist in stressing, first, the essential needs of children of these single-parent families and, second, their child care needs. The first assumption consists in regarding, in both the tax system and the transfer system, the essential needs of the first child in a single-parent family as the equivalent of those of an adult. This corresponds to the principles applied under the existing transfer system. The second entails recognizing for the first child in a single-parent family essential needs which are equal to 150% of those of the first child in a two-parent family. In the second instance, the rate of subsidy for child care expenses would be higher than in the first[6], to provide a greater incentive to work and ensure that the tax and transfer system enables these families to attain a standard of living as high as it would be under the first assumption if they work part-time or participate in reintegration activities. According to this assumption, it might be possible to envisage recognizing 50% of child care costs as a special need throughout the income scale, in addition to the programs for which two-parent families are eligible. Child care expenses of low-income families would thus be 100% covered.

Each of these two assumptions has a distinct method for taking the supplementary needs of single-parent families into account. The following tables and graphs show how these assumptions affect the disposable income of low-income families, the net hourly wages from employment, the net contribution to government financing according to the various levels of income, and the system's neutrality.

For the employed head of a single-parent family, assumption B almost always proves to be the most advantageous in terms of disposable income or net contribution to government financing, since child care expenses are more heavily subsidized than under assumption A (see Table VII.2). This is primarily true under options II and III, where the special need for subsidized child care throughout the income scale reaches 50% (33% under option I). On the other hand, when the reform is fully implemented, for the head of a single-parent family who neither works nor participates in a reintegration activity, assumption A is obviously the most advantageous, as it recognizes that the first child's essential needs are equal to those of an adult and, therefore, are higher than those recognized under assumption B. Following the reform's initial implementation, under option I, where such a head of a single-parent family is not available to search for work or take part in reintegration activities, disposable income under assumption B is the same as under assumption A ($7 046), given that the current level of benefits is guaranteed (see the upper right-hand part of Diagrams VII.1 and VII.2).

Table VII.1

Comparison of the recognized essential needs[1] of the first child in a single-parent family and in a two-parent family
According to benefit scales in effect in 1983
(in dollars)

	Child under 6			Child between 6 and 11		
	Single-parent	Two-parent	Discrepancy	Single-parent	Two-parent	Discrepancy
Family without employment income	2 748	1 609	1 139	2 442	1 303	1 139
Family earning income taxed at the maximum marginal rate	5 193	1 423	3 770	4 256	486	3 770

[1] Does not include child care expenses.

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[6] The rate of subsidy is 67% of child care expenses under option I, and 50% under the other options.

Table VII.2

Change[1] in net contribution between the current system and reform options Single-parent family with one child between 2 and 5 or between 6 and 11
(in dollars)

	Option I			
	Current: without grant for child care expenses		Current: with grant for child care expenses	
Employment income	Assumption A	Assumption B	Assumption A	Assumption B
Child between 2 and 5				
4 000	−844	−589	+259	+514
8 000	−1 886	−2 113	+323	+95
10 000	−1 268	−1 464	+825	+630
12 000	−976	−1 154	+642	+464
15 000	−328	−1 099	+919	+148
17 000	−282	−1 049	+700	−66
21 500	−334	−1 056	−334	−1 056
25 000	−347	−1 060	−347	−1 060
40 000	−453	−1 145	−453	−1 145
50 000	−565	−1 252	−565	−1 252
75 000	−1 091	−1 736	−1 091	−1 736
Children between 6 and 11				
4 000	−625	−131	−297	+197
8 000	−1 187	−926	−519	−258
10 000	−500	−213	+132	+419
12 000	−137	+234	+247	+618
15 000	−189	−465	+76	−200
17 000	−163	−428	+20	−245
21 500	−206	−438	−206	−438
25 000	−236	−457	−236	−457
40 000	−337	−526	−337	−526
50 000	−479	−658	−479	−658
75 000	−980	−1 136	−980	−1 136

[1] A minus (−) sign indicates a reduction in net contribution (or in net (of transfers) tax burden).

Assumption A: The essential needs of the head of the household and the first child equal those of a couple.
Child care expenses are 67% subsidized under option I and 50% under the others.

Assumption B: The essential needs of the head of the household are equal to those of a single person; those of the first child are equivalent to 150% of those of the first child in a two-parent family.
Child care expenses are subsidized in two parts. The first corresponds to the allowance granted to two-parent families. The second recognizes the special child care needs of single-parent families. Under these conditions, the allowance can reach 100% of child care expenses for certain families.

Table VII.2 (continued)

Change' in net contribution between the current system and reform options
Single-parent family with one child between 2 and 5 or between 6 and 11
(in dollars)

Option II				**Option III**			
Current: without grant care expenses		**Current: with grant care expenses**		**Current: without grant care expenses**		**Current: with grant care expenses**	
Assumption A	**Assumption B**	**Assumption A**	**Assumption B**	**Assumption A**	**Assumption B**	**Assumption A**	**Assumption B**
+383	+108	+1 487	+1 211	+325	+111	+1 428	+1 214
−948	−1 983	+1 261	+226	−990	−1 955	+1 219	+254
−618	−1 649	+1 475	+444	−651	−1 608	+1 442	+485
−639	−1 627	+979	−8	−666	−1 577	+953	+41
−453	−1 705	+793	−458	−458	−1 605	+789	−358
−408	−1 638	+575	−656	−424	−1 516	+559	−533
−407	−1 656	−407	−1 656	−414	−1 622	−414	−1 622
−401	−1 644	−401	−1 644	−474	−1 680	−474	−1 680
−428	−1 616	−428	−1 616	−814	−2 003	−814	−2 003
−511	−1 697	−511	−1 697	−1 092	−2 280	−1 092	−2 280
−998	−2 148	−998	−2 148	−2 030	−3 175	−2 030	−3 175
+485	+567	+813	+894	+433	+569	+761	+897
−499	−796	+170	−127	−535	−768	+133	−100
−104	−399	+528	+233	−127	−358	+505	+274
−51	−302	+332	+82	+68	−252	+316	+132
−302	−825	−37	−560	−341	−761	+76	−496
−273	−773	−90	−590	−306	−689	−123	−506
−280	−763	−280	−763	−287	−783	−287	−783
−291	−763	−291	−763	−364	−855	−364	−855
−311	−749	−311	−749	−722	−1 163	−722	−1 163
−425	−853	−425	−853	−1 034	−1 466	−1 034	−1 466
−888	−1 296	−888	−1 296	−1 935	−2 348	−1 935	−2 348

Assumption A: The essential needs of the head of the household and the first child equal those of a couple.
Child care expenses are 67% subsidized under option I and 50% under the others.

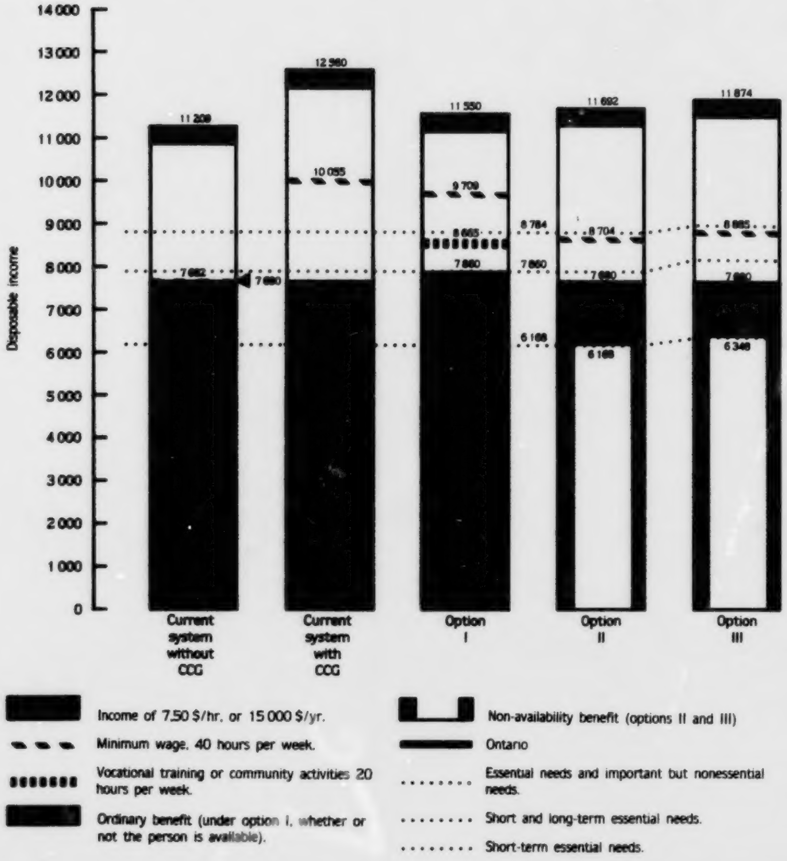
Assumption B: The essential needs of the head of the household are equal to those of a single person; those of the first child are equivalent to 150% of those of the first child in a two-parent family.
Child care expenses are subsidized in two parts. The first corresponds to the allowance granted to two-parent families. The second recognizes the special child care needs of single-parent families. Under these conditions, the allowance can reach 100% of child care expenses for certain families.

Graph VII.1

Single-parent family with one dependent child between 2 and 5

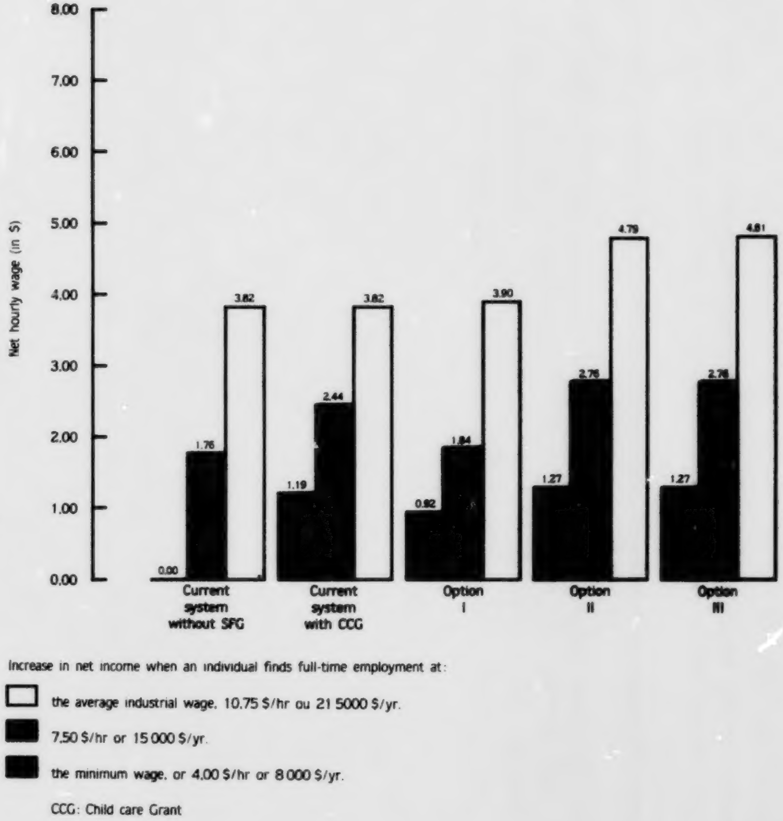
Assumption A:
The recognized needs of the first child are equivalent to those of an adult.

A: Comparison of disposable income
Following the initial implementation of the reform
(in dollars based on 1983 benefits)



CCQ Child care grant: covers 13% of children from low-income families using child care services; the others use non-subsidized services.

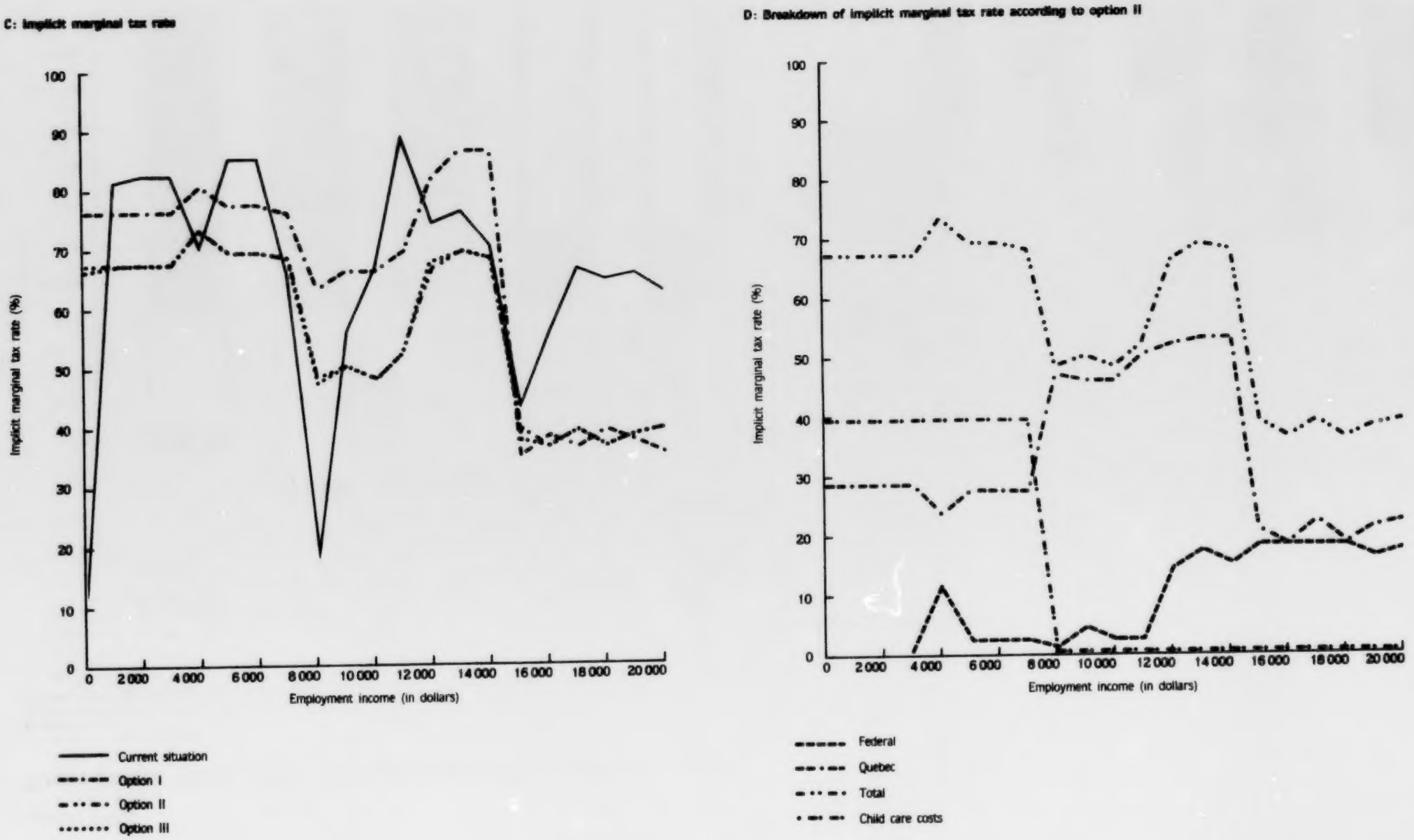
B: Increase in net hourly income when an individual finds employment



Graph VII.1 (continued)

Single-parent family with one dependent child between 2 and 5

Assumption A:
The recognized needs of the first child are equivalent to those of an adult



C: Implicit marginal tax rate

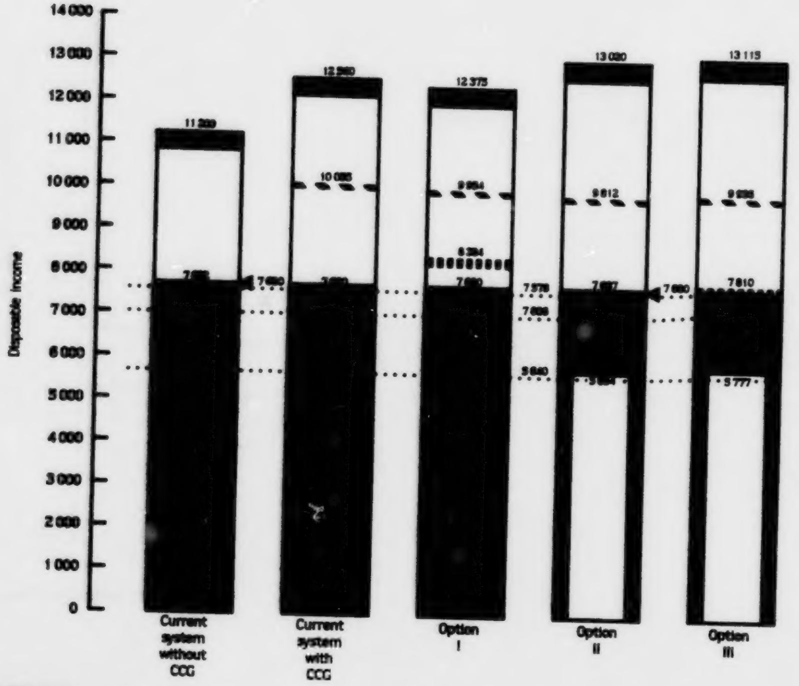
D: Breakdown of implicit marginal tax rate according to option II

Graph VII.2

Single-parent family with one dependent child between 2 and 5

Assumption B:
The recognized needs of the first child are equivalent to 150% of those of the same child in a two-parent family.

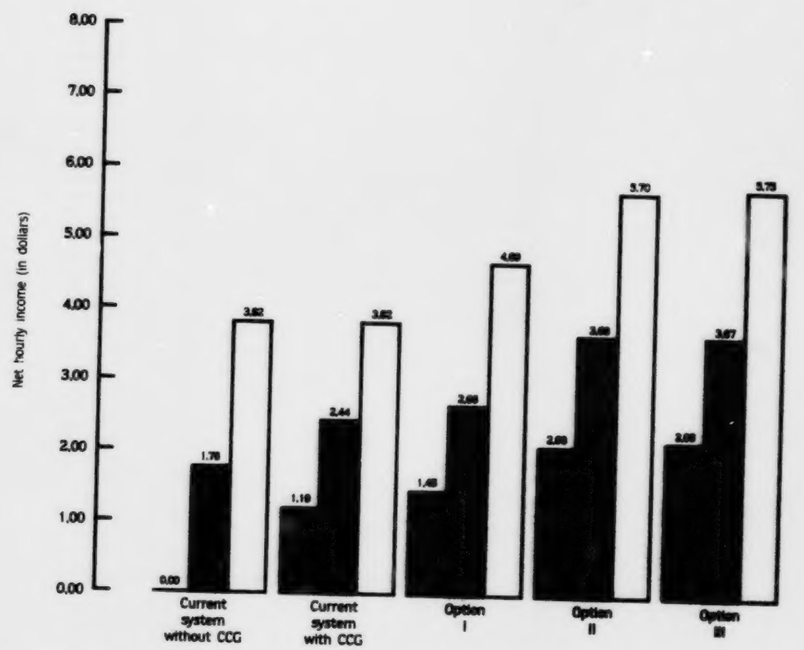
A: Comparison of disposable income
Following the initial implementation of the reform.
(in dollars based on 1983 benefits).



- Income of 7,50 $/hr. or 15 000 $/yr.
- Minimum wage, 40 hours per week.
- Vocational training or community activities 20 hours per week.
- Ordinary benefit (under option I, whether or not the person is available).
- Not-availability benefit (options II and III).
- Ontario
- Essential needs and important but nonessential needs.
- Short and long-term essential needs.
- Short-term essential needs.

CCQ Child care grant: covers 13% children from low-income families using child care services; the others use non-subsidized services.

B: Income in net hourly income when an individual finds employment



Increase in net hourly income when an individual finds full-time employment at:

- the average industrial wage, 10,75 $/hr or 21 5000 $/yr.
- 7,50 $/hr. or 15 000 $/yr.
- the minimum wage (4,00 $/hr or 8 000 $/yr).

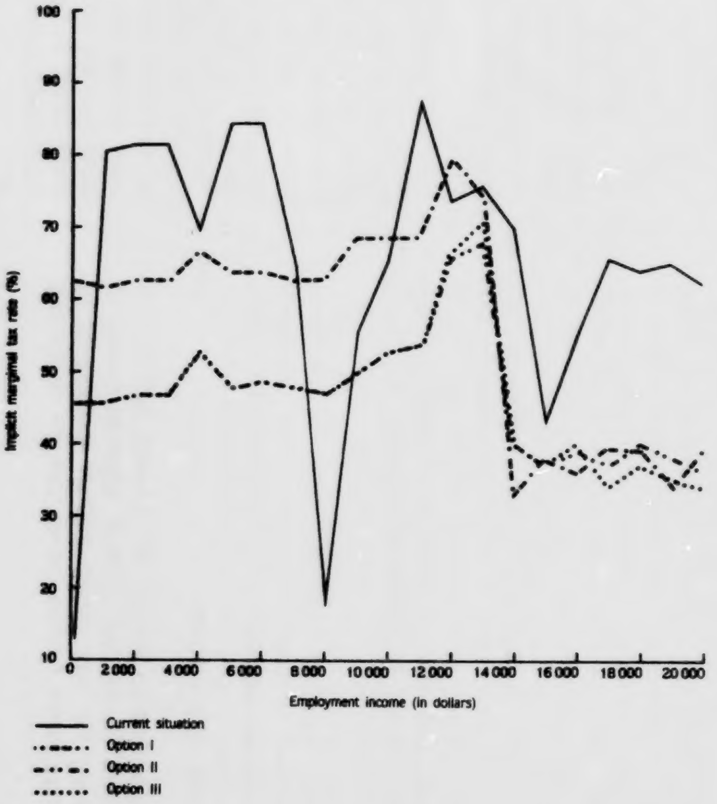
CCG: Child Care Grant

Graph VII.2 (continued)

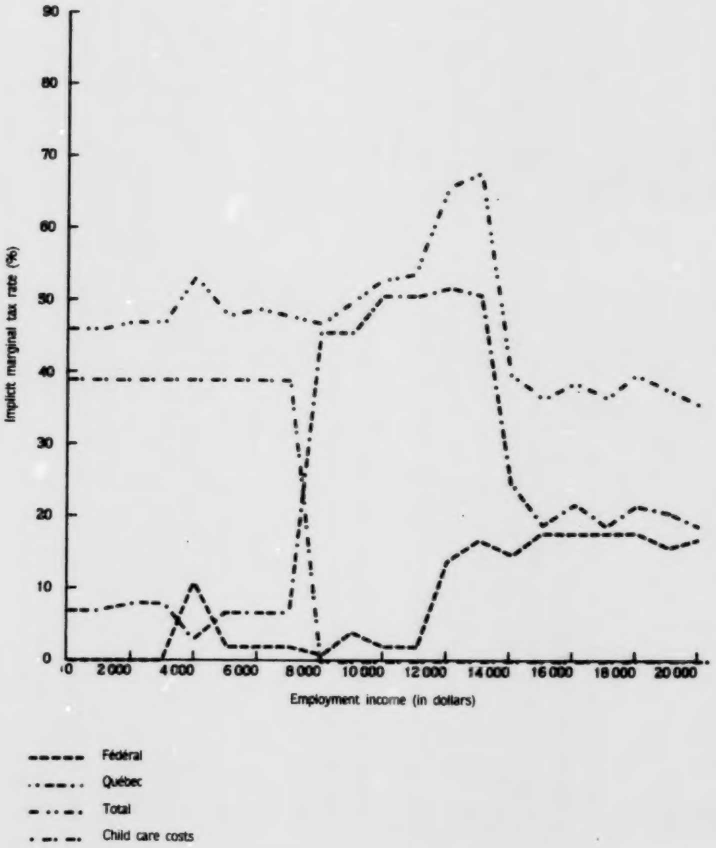
Single-parent family with one dependent child between 2 and 5

Assumption B:
The recognized needs of the first child are equivalent to 150% of those of the same child in a two-parent family.

C: Implicit marginal tax rate



D: Breakdown of implicit marginal tax rate according to option II



It follows that the incentive to seek employment is not the same under both assumptions. For example, for single-parent families with one child between 2 and 5, the net hourly wage (taking child care costs into account) derived from full-time employment at the minimum wage, under option II, increases from $1.27 to $2.08 under assumption A and B, respectively. It should be remembered that under the current tax and transfer system, this family's net hourly wage is $1.19 when it is eligible for the child care grant. Where it is not eligible for it, the net hourly wage is simply zero because of the extent of the costs of caring for this child.

Moreover, it must be noted that the financial incentive to work remains the same under assumption B, regardless of the children's age; under assumption A, the younger the children are, the more limited the incentive to work is. In effect, child care expenses are entirely compensated for under assumption B. Under this assumption, the implicit marginal tax rate which applies when the person obtains employment remains, for example, about 50% under option II. Under assumption A, the implicit marginal tax rate increases to 68% for the same option. Table VII.3, however, shows that either assumption represents an improvement in relation to the present situation, making it possible to reduce the implicit marginal tax rates which apply when an individual finds employment.

The greater incentive to work arising from assumption B has a greater economic impact. Table VII.4 indicates the results of simulations effected in this respect using the general equilibrium model. When both assumptions are applied under option II, the number of jobs created among single-parent families is 30% to 40% greater under assumption B. Indeed, the number of jobs created for such families totals between 9 300 and 16 400 under assumption A, and between 13 300 and 21 400 under assumption B, depending on the hypothesis with respect to households' reaction to the tax environment.

With regard to neutrality, insofar as the choice between forming a single-parent or a two-parent family is concerned, both assumptions for reform continue to give rise to different tax situations as Table VII.5 indicates.

To summarize, assumption B, which puts the emphasis on the high level of expenses related to caring for very young children encountered by single-parent families rather than on recognizing essential needs, offers the choice of a tax structure which provides a much greater incentive to financial independence among these families, regardless of the age of their children. By stressing compensation for child care expenses, this assumption would ensure heads of single-parent families greater long-term financial autonomy. It is also more neutral with respect to the organization of the families (except for those with very young children, because of the very generous nature of child care grants). In terms of disposable income, it might also be said that assumption B is more generous than the present tax and transfer system for working single-parent families with children under 6. On the other hand, among single-parent families which choose to care for their children full time and not depend on government assistance to ensure their needs, the assistance given is more limited and is even insufficient, under options II and III, to ensure their long-term needs. However, single-parent families with either one child under 2, or more than two children under 12, or with a child who is ill or suffering from a mental or physical disability requiring the parent's continuous presence, would receive a higher benefit sufficient to cover their long-term essential needs.

Assumption A, which recognizes the additional needs of single-parent families as essential needs rather than as additional child care needs, attributes a higher level of disposable income to families which choose to take care of their children full time. On the other hand, the incentive to obtain employment is reduced, primarily among families with young children. Assumption A is also less neutral with regard to the organization of households since it encourages couples, as long as they have dependent children, to split up into single-parent families to increase their level of recognized essential needs.

The structure of the tax and transfer systems is not the only element which affects families' decisions; other questions, such as education, social values related to the parents' role with respect to child care, and the conception of the role of women in society, are probably more decisive. Despite this fact, the structure does influence families' behaviour. The sign given to single-parent families by society is important: should financial independence, achieved by lowering the costs of entering the labour market, be favoured, or should the government provide them unconditionally with a higher basic minimun income because of their status as single-parent families? This is one of a number of basic choices on which a consensus must be reached.

Table VII.3

Implicit marginal tax rate which applies when a single-parent with one child obtains employment
(in percentage)

	Current System		Option II	
Employment income rising from:	**Without child care grant**	**With child care grant**	**Assumption A**[1]	**Assumption B**[1]
One child between 2 and 5				
0 to 8 000 $	100	70	68	48
0 to 15 000 $	76	67	63	51
0 to 21 500 $	64	64	55	47
One child between 6 and 11				
0 to 8 000 $	80	71	58	48
0 to 15 000 $	66	64	55	48
0 to 21 500 $	57	57	50	45
One child 12 or more[2]				
0 to 8 000 $	60	60	49	48
0 to 15 000 $	58	58	48	47
0 to 21 500 $	52	52	46	45

1. Assumption A: The essential needs of the head of the household and the first child equal those of a couple. Child care expenses are 67% subsidized under option I and 50% under the others.

   Assumption B: The essential needs of the head of the household are equal to those of a single person; those of the first child are equivalent to 150% of those of the first child in a two-parent family. Child care expenses are subsidized in two parts. The first corresponds to the allowance granted to two-parent families. The second recognizes the special child care needs of single-parent families. Under these conditions, the allowance can reach 100% of child care expenses for certain families.

2. Children between 12 and 15 under the current system and between 12 and 20 under option II.

Table VII.4

Economic impact of the assumptions on the essential needs of single-parent families according to an "average" or "strong" reaction from households
Option II

	Assumption A	**Assumption B**	**Difference**
Increase in working hours as an equivalent of full-time employment of single-parent families	9 300 to 16 400	13 300 to 21 400	4 000 to 5 000

1. This assumption was simulated in chapter VI.

7.5 Integration of the Tax and Transfer Systems

The *White Paper* has shown that, together, marginal tax rates and the marginal reduction rates of various transfer programs unacceptably reduce the monetary advantage of working to low-income earners. With a view to putting an end to this situation, the reform proposes better integration of the tax and transfer systems. To this end, various measures have been proposed: a common definition of essential needs; the fusion, and in certain cases, harmonization, of various transfer programs; exemption from taxation when a household does not have sufficient resources to satisfy its essential needs; and rebate of sales and property taxes relating to essential needs.

Integrating the tax and transfer systems will ensure greater coherence in terms of government initiatives, while allowing the implementation of a simpler system and, undoubtedly, one which would cost less to administer. It will also result in limiting transfer programs to families under the zero transfer floor as other families would, by definition, have sufficient income.

On the other hand, the choice of tax and transfer systems in which the zero tax floor is equal to, or greater than, the zero transfer floor, in order to avoid taxing income necessary to cover essential needs, raises the question of the harmonious indexation of various benefits, exemptions and so forth under the tax and transfer systems. It is thus obvious that the introduction of such a system will affect the government's degree of freedom in elaborating policies respecting taxation and transfer programs.

Table VII.5

Comparison of the net (pre-tax) contribution[1] to Québec government financing of two single-parent families, each with one child, and a two-parent family with two children when both parents earn the same employment income
Current System and Option II
(in dollars)

	Child between 2 and 5			
	Current system Child care grant		**Option II Assumption[3]**	
Employment Income Families Considered	**Without**	**With**	**A**	**B**
No employment income				
Two single-parent families	– 14 262	– 14 262	– 10 964	– 9 938
One two-parent family	– 9 670	– 9 670	– 7 054	– 7 054
Change[4]	4 592	4 592	3 932	2 884
20 000 $ (10 000 $ per adult)				
Two single-parent families	– 3 704	– 8 180	– 4 790	– 7 008
One two-parent family	712	– 2 093	440	440
Change[4]	4 416	6 087	4 350	6 568
40 000 $ (20 000 $ per adult)				
Two single-parent families	2 928	2 402	2 290	– 300
One two-parent family	4 554	4 554	3 771	3 771
Change[4]	1 626	2 152	1 481	4 071

1. The net contribution is shown after deduction of consumption and property taxes.

2. Children between 12 and 15 under the current system, and between 12 and 20 under option II.

3. Assumption A is that under which the essential needs of the head of a single-parent family and those of the first child are equal to those of a couple. Under assumption B, the essential needs of the head of a single-parent family are equal to those of a single person, and those of the first child are equal to 150% of those of the first child in a two-parent family. Moreover, child care expenses are subsidized under this assumption in two parts. The first corresponds to the allowance granted to two-parent families. The second recognizes the special child care needs of single-parent families. Under these conditions, the allowance can reach 100% of child care expenses for certain families.

4. A positive change indicates that the two-parent family with two children contributes more than two single-parent families, each with one child.

7.6 Tax Exemptions, Tax Credits and Family and Spouse's Allowances

The proposed tax reform redefines the recognized level of essential needs, based on what low-income households spend on the satisfaction of such needs. The recognized level has been appreciably raised under the tax system, particularly for dependent children between 6 and 15, for whom only a small portion of essential needs is recognized under the present tax system. On the one hand, the objective is to harmonize recognized basic needs under the tax and transfer systems and, on the other, to ensure that income used to cover taxpayer's and their dependents' essential needs is not taxed.

Under the tax system, the simplest method, and the one which achieves the goal of not taxing income used to cover essential needs in the most satisfactory manner, is the introduction of tax exemptions equivalent to the level of dependents' recognized essential needs. Under the transfer system, dependents' essential needs are covered directly through a corresponding increase in benefits payable. It is for this reason that the reform proposes a tax system which includes exemptions and an income guarantee program incorporating the recognized essential needs of the family. However, it is possible to replace tax exemptions by allowances or tax credits. The current tax system includes a family allowance system to take the needs of dependent children into account, rather than exemptions, as is the case for dependent spouses.

Table VII.5 (continued)

Comparison of the net (pre-tax) contribution[1] to Québec government financing of two single-parent families, each with one child, and a two-parent family with two children when both parents earn the same employment income
Current System and Option II
(in dollars)

Children between 6 and 11				Children 12 or more[2]		
Current system Child care grant		Option II Assumption[3]		Current system	Option II Assumption[3]	
Without	With	A	B		A	B
−13 650	−13 650	−10 964	−9 938	−13 654	−10 964	−9 938
−9 163	−9 163	−7 054	−7 054	−9 165	−7 054	−7 054
4 487	4 487	3 910	2 884	4 489	3 910	2 884
−3 240	−4 618	−3 250	−3 888	−3 182	−1 710	−768
1 018	820	551	551	1 287	940	940
4 258	5 438	3 801	4 439	4 469	2 650	1 708
3 336	3 210	2 978	1 946	3 688	3 662	4 194
5 029	5 029	4 489	4 489	5 446	5 207	5 207
1 693	1 819	1 511	2 543	1 758	1 545	1 013

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2. Children between 12 and 15 under the current system, and between 12 and 20 under option II.
3. Assumption A is that under which the essential needs of the head of a single-parent family and those of the first child are equal to those of a couple. Under assumption B, the essential needs of the head of a single-parent family are equal to those of a single person, and those of the first child are equal to 150% of those of the first child in a two-parent family. Moreover, child care expenses are subsidized under this assumption in two parts. The first corresponds to the allowance granted to two-parent families. The second recognizes the special child care needs of single-parent families. Under these conditions, the allowance can reach 100% of child care expenses for certain families.

There are advantages and disadvantages in using a system of allowances or tax credits to take the essential needs of dependents into account. On the one hand, a system of family allowances makes for greater redistribution of income than a system of exemptions, and guarantees mothers some financial independence by paying family allowances directly to them. On the other hand, it engenders administrative costs and has a negative economic impact by increasing the income tax of families with dependents. However, this is one of the basic choices which must be made to carry out the reform. This choice will have to be made in terms of both dependent children's needs and those of spouses.

The following two sections illustrate the impact of this choice on both groups, taking option II as their reference point.

7.6.1 The tax system as it pertains to dependent children

Under the proposed tax system, recognized essential needs pertaining to children under 21 are based on the expenses of low-income households for their essential short and long-term needs, and for certain important but nonessential needs. Under the income guarantee program, this level varies according to the option and according to the beneficiaries' availability for reintegration activities (options II and III). Table VII.6 outlines these levels.

The transformation at no cost to the government of these tax exemptions into family allowances for children under 18 would make it possible, in place of for instance a $2 892 exemption for two children and the taxation of federal family allowances, to raise Québec family allowances for both children from $211 annually under the current system to $375.

As Table VII.7 indicates, abolition of the exemption for children at the level proposed in option II would result in a $445 million increase in gross personal income tax receipts. However, there are a number of factors which affect the amounts which can be distributed. Some children receive income which reduces the amount of the exemption the parents may actually claim; under a universal family allowance system, this situation would not arise since, regardless of a child's income, family allowances would be paid to the parents. The tax value of income received by children is estimated at $28 million. Next, federal family allowances would no longer be taxed ($127 million) and income guarantee program benefits paid with respect to children would be reduced since part of their essential needs would be covered by family allowances ($42 million). Finally, the shared costs under this program would decrease ($22 million) and the increased tax receipts would, as a by-product, result in higher federal equalization payments ($9 million). In total, the abolition of the exemption for children would free up $323 million which could then be paid as family allowances, that is $375 for two children. Since this substitution would cost the government nothing, the reduction in federal transfers to Québec as a result of the substitution must be offset by an equivalent reduction in the total amount required to pay the family allowances. To summarize, the transformation would reduce personal disposable income by $13 million. A redistribution of income of $28 million would also occur from families whose children earn no income to those families whose children do earn income.

Table VII.6

Exemptions and transfers pertaining to children under 21 according to the various options
(in dollars)

	Exemptions		**Transfers for low-income households¹**	
	First child	**Second and subsequent children**	**First child**	**Second and subsequent children**
Option I	1 668	1 224	1 596	1 200
Option II	1 668	1 224	1 248	1 008
Option III	1 698	1 254	1 278	1 038

1. Transfers include federal family allowances, the federal child tax credit and an additional amount under the income guarantee program. This last amount is based on benefits for recipients who are not available for any activity.

Table VII.7

Impact of the transformation at no cost to the government of the exemptions[1] for children under 18 into family allowances[2], under option II
(in millions of dollars)

1. Change in exemption for dependent children	
— Gross exemption	445
— Impact of children's income on the exemption	(28)
— Tax on federal family allowances	(127)
— Subtotal	291
2. Impact due to other sources	**4**
3. Income guarantee program	**42**
4. Impact on federal transfers	
— Expenditure shared under the income guarantee program	(22)
— Equalization	9
— Subtotal	(13)
5. Impact excluding the cost of family allowances	**323**
6. Cost of Québec family allowances	**323**
7. Overall impact on the financial balance	—

1. The exemptions of 1 668 $ for the first child, and 1 224 $ for the second and subsequent children, and the taxation of federal family allowances are replaced by Québec family allowances of 215 $ for the first child, and 160 $ for the second and subsequent children. In addition, federal family allowances are exempt from Québec income tax.
2. Numbers in parentheses indicate an increase in the government's financial requirements.
3. In a system of exemptions for dependent children, the amount of the exemption is affected by the children's income. However, in a system of family allowances, parents receive the same amount of allowances no matter how much the children earn. The transformation at no cost to the government of exemptions for children into family allowances would reduce family incomes by 41 $ million, which is partially offset by a 28 $ million gain for families whose dependent children earn income.

Table VII.8 indicates the impact throughout the income scale, of this transformation on a couple with two children, according to option II provisions. On income of $13 000 or less, the household's disposable income would remain unchanged: its income guarantee program benefits would fall by $375; instead, it would receive the same amount in family allowances. On income of $15 000, the spouse working outside the home would pay $331 in tax (rather than paying no tax and receiving a $60 payment under the income guarantee program); the spouse at home would receive $375 in family allowance. The household's disposable income would fall by a total of $16. On income of $75 000, disposable income would fall by $265: taxes would increase by $640, and the household would receive $375 in family allowances.

The transformation of child exemptions into family allowances does not affect childless taxpayers or low-income families with children. The redistribution of income resulting from this transformation occurs within middle and high-income households with children. However, as this would lead to a drop in federal transfers, it follows that most households would suffer a loss as a result, especially those with children with no independent income.

Despite its disadvantages, family allowance payments are feasible from two points of view: a family allowance system is more redistributive, and provides a certain financial independence to mothers. However, the system is costly because of the drop in federal transfers it entails, as well as the increases in income tax required to finance it.

Table VII.8

Impact of the transformation of child exemptions (2 892 $ for two children) into family allowances at no cost to the government[1]
Couples with two children between 6 and 11, where one spouse works outside the home according to option II

Household employment income	**Impact on taxpayer's income**				**Impact on government budgets**		
	Family allowance	**Income guarantee benefits**	**Income tax**		**Pre-tax disposable income**	**Change in federal transfers**	**Change in Québec's revenue**
	in $ (1)	**in $ (2)**	**in $ (3)**	**in %[2] (4)**	**in $ (5)=(1)+(2)−(3)**	**in $ (6)**	**in $ (7)=(6)−(5)**
0	375	−375	—	—	—	−187	−187
4 000	375	−375	—	—	—	−187	−187
8 000	375	−375	—	—	—	−187	−187
12 000	375	−375	—	—	—	−187	−187
15 000	375	−60	331	und.	−16	−30	−14
17 000	375	—	463	186	−88	—	88
21 500	375	—	499	44	−124	—	124
30 000	375	—	531	17	−156	—	156
40 000	375	—	574	10	−199	—	199
50 000	375	—	596	7	−221	—	221
75 000	375	—	640	4	−265	—	265

Note: A positive amount means a gain for the taxpayer, except fo income tax.

1. In this example, the children have no income. However, the impact of the transformation on families as a whole would be a $41 million drop in disposable income, which would be partially offset by the impact of family allowances paid to parents with children who earn income.
2. In percentage of tax payable, assuming the proposal for higher exemptions for children is in effect.

Additional administrative costs are also involved in issuing monthly cheques. Given these pros and cons, an attempt should be made to determine whether other means exist for attaining the same objectives.

The government is faced with the following dilemma: how can the vested rights of mothers with respect to family allowances be reconciled, in the reform, with the advantages provided in the income tax system by exemptions for dependent children? One possible solution is as follows: the reform would guarantee to all mothers who so desire, whatever their marital status or family income, the right to receive the existing level of family allowances. Since both the transfer system and the income tax system would take the amount of family allowances received into consideration, the family's disposable income would not change whether or not the mother chooses to receive family allowance payments.

Income guarantee program benefits paid to couples with children and no employment income would be reduced by the amount of family allowances paid to the mother, as is the case under the existing social aid program. As for couples with children and an income high enough to be subject to income tax, the amount of family allowances received by the mother would be taken into account in calculating income tax instalments (either as a deduction at source or as quarterly payments) previously paid by the person claiming the exemption for dependent children.

By proceeding in this manner, the financial leeway required to implement the reform would not be affected (except for the expense of issuing cheques and the possible loss of the federal contribution under the public assistance system of Canada) and, because cheques would be sent directly to those mothers who want them, women's vested rights with respect to family allowances would be preserved. Furthermore, the rationale of the tax and transfer systems, which is based on the recognition, via exemptions, of the essential needs of dependent children, is maintained.

7.6.2 The tax system as it pertains to spouses with no income

As the transfer system is based on the household, financial responsibility for ensuring the essential needs of each spouse is incumbent upon it as well. The government provides assistance when the household's resources are insufficient to cover such needs. On the other hand, if its resources are adequate, the government avoids taxing the income required to cover such needs through a personal exemption for the taxpayer as well as an exemption for the dependent spouse.

As is the case with regard to dependent children, the government has the choice of granting an exemption or paying an allowance for the dependent spouse. According to certain estimates, spouses without income might receive an annual payment of approximately $800 in the form of a spousal allowance, if the spouse's exemption were replaced by a spousal allowance.

In this instance, the transformation of the spousal exemption into a spousal allowance would generally have the same kind of effect as in the case of children. However, such effects would be more marked, as the spousal exemption is higher ($4 392) than that for children ($2 892 for two children). Moreover, such a change would have the following effects: a greater increase in the tax to be paid by spouses working outside the home; a negative economic impact as a result of a greater increase in marginal income tax rates; greater redistribution from high to middle-income families; an even more onerous relative tax burden for a high-income household than for a single person with the same ability to pay; a greater loss of federal transfers to Québec, which would concomitantly reduce the value of the spousal allowance; and additional administrative cost in paying allowances.

More specifically, if the spouse's exemption is replaced with a spouse's allowance, the first dollars (up to income of $4 392) earned by the spouse receiving this allowance would be directly taxed in the hands of this spouse, rather than in those of the spouse already working outside the home (thereby reducing the spousal exemption). Thus, the spousal allowance would be reduced to zero when earned income reached $4 392. For each spouse, beyond this earned income, no spousal allowance would be paid, and the tax system would apply.

Consequently, the transformation of spousal exemptions into allowances for the spouse in the home represents government intervention which would have the effect of redistributing income between the spouse working outside the home and the one in the home. In effect, a surtax would be collected from one spouse, which would be partially remitted to the other and partially to the federal government because its social aid costs would be lowered.

Table VII.9

Relative importance of the main sources of provincial and local revenue derived from individuals before and after the reform, for 1983
(in a percentage)

	Current Situation	**Option I**	**Option II**	**Option III**
Personal income tax	50.5	48.8	48.4	41.0
Consumption taxes	24.2	25.0	25.2	32.7
Municipal and school revenues	18.5	19.2	19.3	19.3
Succession duties	0.4	0.4	0.4	0.4
Revenue derived from the sale of public goods and services	6.4	6.6	6.7	6.6
Total	100	100	100	100

7.7 Income Tax and Sales Tax Combined with a Tax Credit

One of the basic choices presented in the reform options concerns the relative importance of taxes on production as opposed to consumption taxes. For example, under option III $900 million, derived from the broadening of the sales tax base to include a much wider range of goods and services, is used to reduce personal income tax. By reducing personal income tax, the efficiency of the economy as well as the incentive to work, produce and save in Québec are enhanced.

However, such a measure has repercussions on the consumers of these goods and services, and on the industries which produce them. More intensive use of the sales tax compared to income tax will have the effect of redistributing the tax burden because households which devote a greater part of their income to consumption will pay more taxes.

The reform option respecting the broadening of the sales tax will therefore have to ensure, through an increase in the sales tax credit proposed under options I and II, that such taxes are not paid on essential goods consumed by individuals whose income is below the zero tax threshold, and that sales taxes are graduated until an average income is reached. Moreover, specific exemptions would apply to all foods and prescription drugs.

It is in this framework that the choice of attaching greater importance to consumption taxes in financing public expenditure arises. Such a choice would make it possible to improve the incentive to work among middle and high-income earners, and upgrade the economy's overall efficiency. As Table VII.9 indicates, option III would result in an appreciable change in the relative importance of the main sources of revenue derived from individuals.

7.8 A Minimum Income Tax

Personal income tax is the corner stone of Québec's tax system, not only because of its importance as a source of revenue for financing government expenditures, but also because of its role in redistributing income. Furthermore, governments have used personal income tax in another area, less well known perhaps, but which has developed appreciably in recent years, namely, as an incentive for economic development and the accumulation of retirement funds.

Tax breaks designed to encourage savings or investment have thus multiplied over the past few years. These tax measures are generally aimed at middle and high-income earners; they allow taxpayers facing the heaviest tax burdens to reduce their income tax by investing in companies directly, by saving in order to provide capital for businesses, or again by saving for their retirement. The more familiar tax shelters include registered pension plans, registered retirement savings plans, the Québec Stock Savings Plan, research and development tax credits, accelerated depreciation for certain types of buildings, mining depreciation, etc... Taken together, these measures constitute what are commonly called "tax expenditures". They are deliberate choices made by the taxpayer in view of reducing his tax burden.

The multiplicity of these tax deductions, some of which have no effect on the ability to pay income tax, has produced a situation where many high-income taxpayers can, to a large extent, in the extreme case, completely and avoid paying income tax. Given this situation, whether a minimum income tax should be levied against taxpayers in high income brackets to ensure that they make at least some contribution to public expenditures is a matter which should be examined closely.

However, the implementation of a minimum income tax does entail certain problems. To begin with, at what rate and at what level of income would it apply? How should income be defined for the purposes of this minimum tax? Finally, is it reasonable for Québec to act alone in this area, especially as taxes on high incomes are already heaviest in Québec.

Another possible solution to the problem is to simply set an upper limit on the total amount of tax expenditures that could be claimed for a given taxation year. This would have virtually the same effect as leying a minimum income tax. The government will have to act on this matter after having consulted with interested parties following the tabling of the *White Paper*. The matter will also have to be taken up jointly with the federal and provincial governments to ensure that Québec does not act alone.

7.9 Choices for Society and the Government's Preferred Option

7.9.1 Choices for society

In this chapter, we have outlined the basic choices facing Québec society as it undertakes the reform of its tax and transfer systems. In a number of instances, decisions will not be easy to make. The choice of tax and transfer units, the principle of integrating the tax and transfer systems, that of basing the assessment of essential needs on the expenses of low-income households, and choices regarding the relative situation of those who are alone and those under 30 have been made without much difficulty, given the obvious problems of fairness and consistency inherent in the present system.

Certain choices have different implications, as decisions affect not only the means to be employed to attain an objective but also the very objectives which Québec society must, or must not, pursue. There are three such fundamental choices:

1. Is it the unconditional responsibility of the State to ensure, as it does now, that the essential needs of everyone 30 years of age and over (as well as those under 30 who are unable to work or who have children) are satisfied? Or, rather, should a minimum of effort be required from the beneficiary who is able to work, by participating in activities to enhance his "employability"? Two approaches to this question (option I on the one hand, and options II and III) have been set out in the *White Paper*. Québec society is now invited to make its views known. The choice between the two assumptions put forward for single-parent families is posed in the same way.
2. Must we attach greater importance to sales taxes, combined with a credit to minimize their regressiveness, as a source of revenue, although they could have a negative impact on certain sectors of the Québec economy? This is the choice represented by option III, compared with options I and II.
3. Must we encourage greater fairness with regard to taking into account the essential needs of children under the tax system, by way of exemptions for children, given the value of family allowances in ensuring some measure of financial independence for mothers who do not work outside the home? The impact of this choice has been illustrated using option II, although it is apparent in all the options.

With respect to the first choice between a static and a dynamic approach to redistributing income, analyses of their impact demonstrate the marked superiority of the dynamic approach (that requiring a minimum effort from beneficiaries), in terms of both the economy and a more equitable distribution of income. While option I would result in the creation of between 8 000 and 20 000 jobs, options II and III would engender between 38 000 and 79 000. Moreover, option II has a more positive impact on the distribution of income than does option I, while option III has the same impact.

The obvious advantages of the dynamic approach result, on the other hand, in an extensive reorganization of the benefits to be granted under Québec's transfer system. It may be expected that a number of recipients will not adjust readily, particularly when the employment situation is difficult.

The second major choice faced by society concerns the importance of the sales tax to government revenues. Once again, the economic impact of reducing income tax while at the same time expanding the sales tax base would prove to be positive on Québec's economy overall. However, a way must be found to otherwise assist certain weak sectors of the economy. With respect to the negative impact on the distribution of income, it would be limited, as option III includes a concomitant increase in the sales tax credit to avoid taxing the consumption of low-income taxpayers too heavily. This seems to indicate that broadening the sales tax base could be a desirable move in terms of reorganizing the tax system.

The third choice is equally hard to make, as it involves contradictory objectives. As is the case with the two preceding choices, it is up to Québec society to indicate its preferences. It is a matter of determining to what extent the objective of ensuring a certain financial independence for mothers who do not work outside the home, should prevail, while a system of exemptions for dependent children would prove to be more equitable (by avoiding taxing income devoted to essential needs) and less costly (because of federal transfers and administrative costs).

Thus, the reform of the personal tax and transfer systems confronts Québec society with very crucial choices. On the one hand, the reform presumes that we know toward what type of society the present tax system is leading us, and that we shall decide together what kind of society Québec wants for the future. On the other hand, such a reform demands that we also ask ourselves about the level of public spending in Québec. Less public spending would enable us to more easily and more quickly attain all the economic and social objectives we are seeking, and would also simplify the choices to be made.

7.9.2 The government's preferred option: option II

The basic choices described above obviously lead to the final choice which must be made with respect to the reform: of the three options proposed in the *White Paper*, which is most likely to serve the interests of Québec society as a whole? As has been emphasized time and again throughout this document, each of the options presents a different vision of society; it is up to the government to make a choice.

Option I calls for a high level of benefits without requiring the beneficiary to take part in programs which will prepare him for the labour market. It basically maintains the status quo with respect to social policy and transfers and, as a result, does little to increase the incentive to work among beneficiaries of transfer programs and low-income workers.

As such, it is difficult to see how option I can effectively deal with the problems Québec is currently experiencing in the fields of transfers and personal income tax. In the final analysis, option I proves to be not only the most costly for the Québec government, but also the alternative which is least likely to offer lasting solutions to the problems facing Québec society. Indeed, even though it provides for a reduction in income tax, option I would continue to tax persons at the bottom of the income scale at implicit marginal rates which exceed those applicable to high-income taxpayers. For a society seeking to break poverty's vicious circle, that is unacceptable.

Option III, which shifts some of the tax burden from production to consumption, is the most ambitious alternative. It provides the greatest chance of achieving the goals of the reform with respect to economic efficiency, production and employment. It thus has the greatest impact on the economy. However, inspite of these significant advantages, option III leaves some questions unanswered. To begin with, there are a number of tax measures already in place designed to encourage savings, while at the same time, the present level of consumption does not appear to be sufficient to support a lasting recovery. What would be the short-term effect on the economy of Québec of a policy which would expand the sales tax base? Although option III would promote the growth of the economy in the long term, the short-term risks must be carefully weighed.

It should be remembered that the demand for products from the weak sectors of Québec's economy grew appreciably following the introduction of selective sales tax exemptions. What has been the impact of these measures on the ability of these sectors to adapt to the new climate of international competition under the GATT agreements? The final tally is yet to be produced.

Expanding the sales tax base as called for under option III is a significant change in the orientation of our tax system and must be submitted to the citizens of Québec. Only after the people of Québec have been consulted, and the final impact of the system of exemptions on the weak sectors of the economy is known, will the government be in a position to decide whether it should pursue the objectives of the reform as vigorously as provided for under option III.

Given these constraints, the government has decided on option II as its preferred alternative since, under this option, the essence of the objectives sought by the reform may be obtained in the short term without questioning the major orientations of our income tax system, which is the major component of our tax system. Option II provides for a reduction of the tax burden of families with children which derive no particular benefit from the existing system. It also provides for a reduction of the tax burden of most middle-income taxpayers, whose marginal rates of income tax are too high. And finally, it will improve the competitive stance of our tax system relative to that of our neighbours with respect to high-income taxpayers.

Under option II, low-income workers retain a larger proportion of any increase in employment income, so that their incentive to work and their disposable income are both improved. In addition, it encourages individuals to take the initiative by providing them with the means to successfully enter the labour market (academic upgrading programs, on-the-job training in industry, community work, etc.) and by employing the transfers paid to them to encourage them to remain active and improve their "employability".

It should be understood, nevertheless, that the government's position is by no means final. Like the entire *White Paper*, it will be submitted to the population for its approval. The attraction of option II lies in the fact that it embodies a middle position which is more likely to reconcile the divergent interests encountered throughout society while at the same time, offering a real solution to the problems facing Québec in the realms of personal taxation and transfers.

Should it become apparent, following the consultations which will be undertaken once the *White Paper* is tabled, that there is a strong consensus in favour of option I or III, the government will have to take that into consideration in laying out its policy with respect to personal taxation and transfers. A consensus in favour of option I would mean a preference for the status quo, and could call into question the government's decision to undertake a thorough reform of the tax and transfer systems. Should a consensus emerge in favour of option III, however, that must be taken as a sign that society favours a more vigorous pursuit of the reform's objectives. As a result, a consensus in favour of option III would indicate that the population supports a change in the thrust of taxation policy towards greater utilization of general consumption taxes relative to taxes on production and employment.

Summary

Summary

The *White Paper on the Personal* ***Tax*** *and* ***Transfer Systems**** is made up of seven Chapters, a Foreword and an Introduction. The first three chapters describe the field of personal taxation and **transfers** in Québec, and attempt to place it in context. Chapter IV presents a general outline of the reform, while the last three chapters set out the solutions and their impact in greater detail. This summary follows the order of the chapters.

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* Terms in boldface type are defined in the glossary.

Foreword

The social context and general background for the reform of personal taxation and transfers are described in the Foreword. It begins by recalling the growth and development of public spending in modern states, and how it has been financed since the Great Depression. This section recounts how most of the social measures we have today took shape over the years, and how the government progressively came to assume responsibility for economic stabilization and income maintenance.

The welfare state grew out of the uncoordinated addtion and juxtaposition of these measures; its existence was called into question for the first time during the 1981 recession. In Québec, the role of the government began to expand in 1960, the beginning of the Quiet Revolution. Québec had not only to make up considerable ground with respect to public services, but also had to assume responsibility for the assertion of its identity as a distinct society, to the point where, in 1977, the **tax burden** of individuals in Québec was 20% greater than that of their counterparts in Ontario.

This situation gave rise to a strong disincentive to work, specially among the unemployed, who stood to lose the greater portion of what they would earn if they reentered the labour market. Municipalities, meanwhile, inundated by government grants, had a greater incentive to obtain as much government money as possible rather than deal with the real needs of their citizens. Heavily taxed businesses came to think that any improvement in their performance would only serve to finance government expenditures.

The government has already taken certain initiatives in response to this situation, namely, the two reforms of municipal taxation and business taxation. The personal tax and transfer systems must now be adapted to the new situation and its demands.

Introduction

The Introduction reviews the developement of taxation and transfer policies with respect to individuals over the past few years. It analyses in some detail how the problems of incentive to work and dependence on the government came to be and came to characterize an increasingly significant segment of the population. Two factors are singled out: the lack of coordination among the different transfer programs, and the lack of **integration** between the **tax system** and the **transfer system**.

To begin with, the new economic and social context is outlined. This context has made it imperative for Québec society to take a closer look at many elements of the existing tax and transfer systems. The recent recession, the flood of new social aid recipients, the emergence of new values with respect to work and the family, women's desire to be more active in the labour market, and the increasingly stiff competition in international trade have all contributed to the necessity of rethinking and integrating the tax and transfer systems.

Chapter I

Constraints and Objectives of the Tax and Transfer Systems

Chapter I identifies the constraints and objectives which must be taken into account while the reform of the personal tax and transfer systems is being put into effect.

With respect to objectives, the *White Paper* mentions that not only must the tax and transfer systems collect the resources necessary to finance government expenditure, they must also fulfill the following expectations:

— general:
  - distribute the tax burden fairly among taxpayers;
  - be simple to administer and easy to understand.

— economic;
  - ensure that they are competitive with the tax systems in neighbouring provinces and regions;
  - ensure economic efficiency by way of a high degree of incentive to work.

— social:
  - ensure an acceptable **redistribution of income** by guaranteeing each person sufficient income to cover his essential needs and by levying a **net contribution** which increases with **ability to pay**.

However, the realization of these objectives is complicated by the existence of a number of constraints, the most important of which are the following:

— The size of the public sector: Québec's public sector is the largest in Canada, both in relation to population and in relation to **gross domestic product** (GDP); as a result, Québec's tax system must generate greater revenue and is likely to have more serious consequences on the economy which supports it;

— the degree of openness of Québec's economy: the gouvernement du Québec's room to manoeuvre is severely limited, insofar as setting high **marginal income tax rates** is concerned, by the fact that Québec exports 40% of what it produces (and imports 40% of what it consumes).

— the tax pressure limit: in Québec as anywhere else, it simply is not possible to increase taxes indefinitely. A point is eventually reached beyond which any increase in taxes results in an offsetting shrinkage in the **tax base**, so that there is no significant increase in tax revenues;

— the overall tax environment: because of this constraint, Québec cannot adopt a tax system which is radically different from those in effect in neighbouring regions. In this regard, the growing movement in favour of heavier taxation of consumption expenditures in North America should be followed very closely;

— Québec's participation in the federal system: two tax and transfer systems are in effect in Québec, more or less different, more or less complementary, and constantly having to be kept in harmony. Furthermore, because it participates in the federal system, Québec must formulate its tax policy while bearing in mind its impact on federal transfer and **equalization** payments and on payments made under the Canada Assistance Plan.

Chapter II
Characteristics of the Personal Tax System

Chapter II analyses the structure of Québec's personal tax system. The chapter is divided into three parts: a comparison of Québec's tax system with other systems (Ontario and other countries), an analysis of the problems it gives rise to, and its impact on the **disposable income** of taxpayers and their incentive to live and work in Québec.

2.1 A comparison of Québec's system with other systems

In 1981, some countries, such as Japan, the United States and Switzerland, devoted some 30% of their gross domestic product to financing the various levels of their governments. At the other end of the scale, Sweden devoted 51%, the Netherlands and Denmark 45%. Québec falls in the middle of the scale; roughly 36% of its domestic output goes to finance its various levels of government, compared with 33% for Ontario and Canada as a whole.

Taxes are heavier in Québec than in Ontario in relation to **GDP**. It should also be noted that taxes on production activities (personal income tax, taxes on profits and wages) account for 42% of taxation sources in Québec, against only 30% for Ontario which places more emphasis on consumption and wealth (59% in Ontario compared with 51% in Québec).

The **tax burden differential** of Québec taxpayers compared with their Ontario counterparts amounted to about 10% in 1983 for the tax system as a whole, that is 24% more with respect to personal income tax and health insurance premiums and slightly less with respect to **consumption tax**. At the municipal and school board levels, Quebecers paid 12% less in taxes of all kinds than they would have under Ontario's tax structure.

2.2 Problems stemming from the existing system of taxation

The existing system of taxation gives rise to a number of problems related to **equity**. The system takes different categories of income into account in different ways, and does not allow the deduction of certain employment-related expenses. The following instances are worthy of mention:

- The **personal exemptions** claimed by a taxpayer do not necessarily correspond to his essential needs. Some taxpayers are afforded better treatment than others. No exemption may be claimed for a de facto spouse, while the system grants the highest level of exemptions to a married couple in which both spouses work outside the home. Heads of single-parent families and the elderly also receive preferential treatment from the equivalent to married exemption and the age exemption respectively.

- Another problem of equity arises from the absence of personal exemptions for dependent children under 16, even if they have been replaced with family allowances. Under the existing tax system, part of the income which is used to cover the essential needs of some children is subject to tax; this is the case for the first child of any family, regardless of its income, as well as for all the children of high-income families.

- The tax system does not make adequate allowance for the expenses actually incurred by students in pursuing their studies; deductions are restricted to tuition fees only. Furthermore, the deduction is not transferable to the person who, under the student assistance program, is deemed to be supporting the student, nor can it be carried over to subsequent years if it cannot be applied in the current year.

- Many existing exemptions or deductions must be reviewed. Some exemptions are no longer justified, such as the first $500 of income from grants and scholarships. At the same time, some deductions are too generous, while others are inadequate. For example, the $2 000 maximum child care expense deduction for each child appears to be excessive for school age children, but insufficient for pre-schoolers.

- The tax system in effect in North America provides little incentive to save and invest, and applies double taxation in certain instances. Only that portion of investment income (interest and dividends) which is in excess of inflation should be subject to tax. Otherwise, the system is taxing that portion of such income which is required to maintain the real value of capital.

2.3 The impact of the existing system on the disposable income of taxpayers and on the incentive to live and work in Québec

An analysis of the **overall tax burden** of a certain number of typical households demonstrates that, in 1983, most taxpayers in Québec paid higher taxes than they would if they lived in Ontario. A single person who earns more than $15 000 per year pays higher taxes in Québec. The situation is similar for childless couples (and single-parent families with one child) who earn more than $26 000; for couples with two children, equality in the tax burden is attained at an income between $25 000 and $30 000 depending on the age of the children.

The additional tax burden for the Québec taxpayer, compared with his Ontario counterpart, increases with income. At the $100 000 income level, the differential reaches $5 000 for a couple with two children, and more than $7 000 for single person with no dependents.

The size of this disparity is reduced by two factors. First, a taxpayer in Québec may reduce his taxes by participating in the Québec Stock Savings Plan. Second, the cost of living is lower in Québec, mainly because housing costs are lower.

Despite these two factors, taxation continues to have a negative impact: the high tax burden reduces the incentive for high-income earners and specialized workers to live and work in Québec. In others words, Québec's comparative advantage with respect to cost of living and, in particular, housing costs, is reduced, if not completely nullified, by its tax burden

2.4 The progressivity of the Québec tax system

Compared with Ontario's, Québec's tax system is strongly **progressive**. To illustrate, the **average** overall **tax rate** for a family with two children and a single employment income increases from 7% at an income of $15 000 to 45% at an income of $100 000. In Ontario, the corresponding rates are 13% and 40%.

The greater progressivity of the Québec system can be explained as follows:

- The income tax structure is more progressive in Québec. At the low end of the income scale, marginal tax rates are comparable in Québec and Ontario. However, Québec's maximum marginal tax rate (including federal income tax) was 60.4% in 1983, compared with only 50.7% in Ontario. Under the Québec tax table, the maximum marginal rate is reached at a **taxable income** level of about $60 000.
- Ontario makes greater use of **consumption taxes, property taxes** and premiums (for example, health insurance premiums) to finance government expenditures. All of these taxes are much more **regressive** than the income tax.

Chapter III

Characteristics of the Transfer System and Problems of Integration with the Tax System

Chapter III begins with a brief description of Québec's transfer system with respect to individuals. In the second section of the chapter, the level of benefits paid under the Québec system for different categories of households is compared with what it actually costs to cover the essential needs of these same households, and with the level of benefits paid in Ontario.

Subsequent sections examine the transfer system from the point of view of economic efficiency, incentive to work, **redistribution of income** and equity among taxpayers. The last part of the chapter deals with the integration of the tax and transfer systems, their harmonization with government policies, and their impact on the economic and social behaviour of beneficiaries.

3.1 General description of the transfer system and its main programs

A multitude of programs make up the Québec system of transfers to individuals. These programs may be divided into three major groupings according to function:

- a guaranteed basic minimum income (11 Québec programs and five federal programs);
- employment income maintenance (six Québec programs and two federal programs);
- assistance for entering the labour market (two Québec programs).

3.2 A guaranteed basic minimum income

Social aid is the principal program designed to ensure a basic minimum income; the others are family allowances, the federal child tax credit, the Québec availability allowance, the **property tax refund** and certain programs designed for special needs such as free medication, free ambulance service, legal aid and housing assistance.

Chapter III's analysis of the programs guaranteeing a basic minimum income leads to the following conclusions:

- Over the past ten years, and for most categories of households, the diposable income of households receiving income security benefits has grown more rapidly than the disposable income of taxpayers earning the average industrial wage.
- The guaranteed basic minimum income is higher in Québec than in Ontario for all categories of households in which the head of the household is able to work, except single persons 21 to 29, and childless couples in the same age group. The gouvernement du Québec could cut its expenditures by $150 million by applying the Ontario benefit scales for households whose head is able to work.
- Exception being made of single persons and childless couples under 30, the guaranteed basic minimum income under the Québec transfer system provides benefits equal to the amount low-income households spend to cover their **short** and **long-term essential needs** (low-income households are defined as those whose income is derived mainly from employment and was less than $13 700 in 1983).
- Contrary to most other systems in the world, the transfer system in Québec provides the same level of benefits to those who are able to work as to those who are not (except for those under 30 without children).

3.3 The transfer system and economic efficiency (incentive to work)

The transfer system suffers from some serious problems on this score, especially with respect to the incentive to work among low-income workers. For many of these workers, there is little benefit to be derived from returning to the labour market because of the combined effect of an increase in taxes and a reduction in transfers. As an example, the head of a family with two children under six has a disposable income of $10 941 as a social aid beneficiary. Should he accept a job at the minimum wage ($8 000 per year), his disposable income would move to $12 640, a net increase of $1 699[1]. In other words, governments will have withheld, in taxes and reductions in benefits,

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[1] Disposable income is defined as follows: the sum of social aid benefits or employment income (whichever is appropriate), employment income supplement benefits, federal and Québec family allowances, the federal child tax credit, the Québec availability allowance and property tax refund less federal and provincial income tax and QPP as well as unemployment insurance contributions payable.

$6 301 of his $8 000 earnings, equivalent to an **implicit marginal tax rate** of 79%.

The increase in his **net hourly wage** is therefore $0.85, without allowing for the additional expenses incurred in going to work. If child care expenses and the loss of other specific benefits the household may have been entitled to (special needs under social aid, subsidized rent, student assistance for children who are studying, etc.) are added to the taxation and transfer effects, it can happen that, in some cases, the worker must pay to work, since his implicit marginal tax rate exceeds 100%.

3.4 The transfer system and redistribution of income

One of the transfer system's major functions is to redistribute income from the wealthiest to the poorest. The analysis carried out in Chapter III demonstrates that in spite of the multiplication of **transfer programs** and the significant sums injected into the fight against poverty, there has been no improvement in the distribution of income.

The effect of increased transfers to the disadvantaged segments of the population has been nullified by a drop in their employment income. The question must be asked as to whether one of the causes is the incentive, which the existing system fosters, to become or remain dependent on government support. In contrast, a system which included an incentive to undertake an initiative to become reintegrated into the labour market would be more likely to offer a way off the poverty treadmill.

3.5 The transfer system and the question of equity

Chapter III demonstrates that the existing transfer system is inequitable on several counts:

— Because the various programs are poorly integrated, there is double coverage of some needs, while others are inadequately provided for. For instance, property taxes paid by social aid recipients are refunded as part of the basic benefits under social aid and by the property tax refund to which they are entitled.

— The transfer system affords different treatment to different categories of recipients. The most notable examples are single persons and childless couples under 30.

— Social aid provides more financial support than the student assistance program to young people 18 to 21. There is thus an incentive to remain inactive.

— The income guaranteed to persons 65 or over who have never contributed to the Québec Pension Plan is 25% to 40% higher than that guaranteed to persons between 30 and 64 who are single or married, respectively.

— Up to now, the issue of assistance for child care expenses to make it easier for the head of a single-parent family or for a second spouse in a two-parent family to enter the labour market has been neglected. With respect to pre-school age children, the tax deduction for child care expenses is insufficient and in many cases covers only two thirds of expenses actually incurred. The child care allowance is granted only to households which make use of child care services recognized by the Office des services de garde à l'enfance. Since most parents must turn to services which are not recognized, the allowance reaches only 13% of children who would normally be entitled to it if all types of child care services were recognized. Furthermore, a significant portion of this assistance is paid to households which receive social aid and do not participate in the labour market to the slightest degree.

Chapter IV
General Outline of the Reform of the Personal Tax and Transfer System

Chapter IV marks a transition between the problem situation set out in the first three chapters and the detailed presentation of the reform options and their impact which occupy the final three chapters. The chapter begins by briefly outlining the major proposals contemplated for ten general theme areas, such as the incentive to work, coverage of basic needs, assistance to low-income workers as well as the tax treatment of the elderly and single-parent families.

The chapter concludes by briefly describing each of the reform options, and with a summary of how the reform will be financed and whom it will benefit.

Chapter V
The Proposed Reform

Chapter V describes the general orientations of the reform as well as the principles on which it is based and how it will be applied. The reform may be summarized by distinguishing between those elements common to all three of the options and those which are specific to each of them.

5.1. The common elements of the reform

5.1.1 Concerning the tax system

a) A reform of the system of personal exemptions so that, for each type of household, the income necessary to provide for essential needs is not taxed, and so that certain problems in the existing system may be remedied. As a result:

- the basic personal exemption is adjusted to correspond to the level of recognized essential needs;
- the basic personal exemption and the married person exemption are made equal in order to harmonize the exemptions granted to couples in which both spouses work with those granted to couples in which only one is on the labour market, and the married person exemption is extended to de facto spouses;
- a new exemption is introduced to compensate single persons who live alone in a separate dwelling for their additional needs;
- the tax system is more advantageous for families since it takes fuller account of the essential needs of dependent children; a new system of personal exemptions for dependent children under 16 is proposed; however, the existing family allowances will be maintained for families who so desire. The availability allowance is retained only for children under 2;
- the exemption for other dependent persons 21 or over is increased, and a new exemption for the first child in a single-parent family replaces the current equivalent to married person exemption.
- the maximum amounts of exempt income for personal exemptions are abolished. From now on, personal exemptions will be reduced by the first dollar of income earned by the dependent.

b) A reduction in marginal income tax rates, particularly for middle and high-income earners, to make the Québec tax system more competitive, and the incorporation of the current 3% tax reduction into the new tax table.

c) An increase in the standard deduction for employment-related expenses from 3% to 6%, with the maximum deduction going up to $750 from its current level of $500.

d) The reworking of the child care expense deduction to take fuller account of expenses actually incurred;

- maximum deduction for children under six increased from $2 000 to $3 120 (1983 dollars);
- maximum deduction for children 6 to 11 set at $1 560
- the deduction may be claimed by the spouse with the greater income;
- abolition of the deduction for children 12 and 13.

e) A new system of tax credits to compensate low-income taxpayers for property taxes and sales taxes they pay on expenditures to cover essential needs.

f) A dependent student's deduction for tuition fees will be transferable to the parents, and the student will have the option of carrying the deduction forward to the following year;

g) Considerations of equity and the concern to remain within its stated financial leeway in carrying out the reform have led the government to abolish the following measures:

- the general 3% tax reduction, which will be incorporated into the tax table;
- the exemption of the first $500 of income from grants and scholarships;
- the general $100 deduction;
- the maximum amounts of exempt income for the spouse's deduction, and the deduction for children and other dependents. These deductions will now be reduced by the first dollar of income earned by the dependent;
- the $2 100 age exemption for older persons who are still at work.

5.1.2 Concerning the transfer system

a) For persons who are able to work, a single income guarantee program would be created which would consolidate the various programs currently available to them: social aid, the employment income supplement, child care assistance, family allowances, availability allowance and the property tax and sales tax credits.

b) The situation of low-income workers would be improved in order to encourage them to remain at work. They would become eligible for benefits in addition to their employment income within the new income guarantee program, and would not have to pay income tax as long as they remained eligible to receive transfers. Persons under 30 who are not currently eligible would also become eligible to receive employment income supplement benefits.

c) A financial incentive would be tied to "employability" enhancement activities for income guarantee program recipients. Supplementary benefits would be paid to beneficiaries who are available to undertake an initiative to reintegrate themselves into the labour market (industrial training, further education, community work, etc.), following the lead of the programs recently announced by the government.

d) The benefits under the income guarantee program would be set to equal the amounts spent by low-income households to satisfy their essential needs. Low-income households are defined as those whose income was less than $13 700 in 1983 and was earned mainly from employment. Incomes less than $13 700 are those of heads of household or spouses working full-time who fall into the first income decile (first ten percent). Where necessary, child care assistance would be added to these benefits.

e) The existing social aid program would be maintained for persons considered unable to work. However, they would have the option of participating in the income guarantee program. Special assistance would be given to persons who are temporarily unable to work.

f) The student assistance program would be harmonized with the new income guarantee program by taking the income of the parent into account when calculating the amount of benefits paid under the income guarantee program to beneficiaries 18 to 20. This measure will apply only to beneficiaries who turn 18 after the reform comes into effect.

g) A major reworking of the child care expense subsidy so as to:

   - integrate the child care expense subsidy (50% to 67% of expenses incurred, depending on the option), which would be added to recognized essential needs, into the income guarantee program;
   - extend the child care expense subsidy to cover all types of child care services and not only those establishments licenced by the Office des services de garde à l'enfance.
   - make the maximum eligible expenses equal to those under the income tax system, namely $3 120 for each pre-school child and $1 560 for each child between 6 and 11;
   - make child care assistance available both to those who participate in programs providing preparation for employment and to low-income workers.

5.1.3 Concerning the integration of the tax and transfer systems

a) A lump-sum tax reduction would be introduced, raising the zero tax threshold and thus preventing the simultaneous application of the tax system and the transfer system. A taxpayer would thus not pay income tax as long as he continued to receive income guarantee benefits.

b) A common indexation mechanism would apply to the tax and transfer systems. Transfers and personal exemptions would be indexed at uniform rates.

c) The tax and transfer systems would adopt common, or at least compatible, definitions of income, assets, needs to be taken into account, declaration unit and accounting period.

5.2 The distinctive elements of the various options

The elements which are specific to each of the various options are summarized in Table A. They deal with the level of the income guarantee benefits, the implicit marginal tax rates applicable to low-income workers or to persons entering the labour market, the tax table, the progressivity of the tax table, the zero tax threshold and the extent to which sales taxes are used to finance government expenditures. Each of these various elements is operative subject to the overall constraint of a $600 million financial leeway.

Each of the reform options deals with these four points in different ways:

5.2.1 The amount of taxes payable

Each of the reform options brings significant changes to the system of personal taxation. First of all, the zero tax and transfer thresholds[2] will be harmonized in order to improve the integration of the tax and transfer systems. In this way, no taxpayer will be liable to pay tax while he is eligible to receive transfers.

The zero tax threshold for all taxpayers will be significantly increased by lump-sum tax reductions so as to provide a greater incentive to work. To illustrate, a couple with two children between 6 and 11 and only one spouse working outside the home currently pays tax in Québec only when its income exceeds $11 918. Under option I, this threshold would be raised to $16 005, to $16 588 under option II, and to $18 948 under option III.

Furthermore, each option would reduce the number of taxable income brackets and the progressivity of the Québec tax table. The maximum marginal tax rate, currently 32% in the Québec table, would be reduced to 30% under each of the options except option III, where it would be set at 28%. Option III therefore brings about the largest tax reduction for middle and high-income taxpayers.

5.2.2 The level of transfers and recognized needs

The distinctive elements of each option are summarized in Table A. Option I adopts a traditional approach in the sense that, with respect to the level of benefits it provides for, no distinction is made

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[2] The zero tax threshold or zero transfer threshold is defined as the level of income at which an individual is no longer eligible to receive transfers or becomes subject to income tax.

Table A

Principal distinctive elements of the various options

Option	Essential needs covered by income guarantee benefits[1]			Implicit marginal tax rate on low-income earners	Maximum marginal tax rate on high-income earners[3]	Minimum income subject to maximum marginal rate	Income tax reduction	Broadening of sales tax base	Zero tax threshold[4]
	Persons who are active[2]	Persons who are available but not active	Persons who are not available						
I	In excess of short and long-term	Short and long-term	Short and long-term	67%	58.4%	69 773 $	Average	No	16 005 $
II	Short and long-term	Short-term plus clothing	Short-term	50%	58.4%	70 562 $	Average	No	16 588 $
III	Short and long-term	Short-term plus clothing	Short-term	50%	56.4%	71 760 $	High	Yes	18 948 $
Present system	Short and long-term essential needs			75% to 100%	60.4%	60 714 $			11 918 $

1. Short-term essential needs consist of current expenditures requiring at least monthly payments, such as food, housing, communications, household services and personal services. Long-term essential needs include those which do not occur on a regular basis, such as furniture and clothing. Important but nonessential needs include expenditures for public transportation, recreation and reading material.

2. Persons taking part in reintegration activities.

3. Including federal income tax.

4. The zero tax threshold shown applies to a married taxpayer with two children between 6 and 11, whose spouse does not work outside the home.

between persons who are available to undertake a program of reintegration into the labour market and those who are not, that is, equivalent to short and long-term essential needs. Options II and III also provide sufficient income to satisfy short and long-term essential needs, but they require that beneficiaries remain active either by taking part in reintegration programs or by working part-time. Options II and III would apply a new scale of penalties, in keeping with the spirit of the current *Social Aid Act*, which would reduce the benefits payable to beneficiaries able to work but who are not available for a reintegration activity or to search for employment to what is required to cover short-term essential needs. Persons who are not active but are available to participate in a reintegration activity or to search for employment would receive their current level of benefits during the initial implementation phase of the reform. These benefits will be indexed to the cost of living when they equal the amount of short-term essential needs plus clothing.

5.2.3 The implicit marginal tax rates applicable to low-income earners:

Under the existing system, when a social aid recipient reenters the labour market at a low wage level, he loses almost all of the extra income he earns to the government. Not only must he pay income tax, assuming his income is high enough, but his social aid benefits will be reduced one for one by each dollar he earns, with the exception of a 6% deduction for employment-related expenses ($300 maximum). His implicit marginal tax rate is therefore 94%, which may be reduced to 75% if he qualifies for the employment income supplement program.

The various reform options put forward by the *White Paper* provide for various levels of transfers and, as a result, different marginal transfer reduction rates. Benefits under option I are relatively high, and the incentive to work relatively low, since the recipient would face an implicit tax rate of 67% were he to accept a low-paying job.

Options II and III are clearly superior in terms of incentive to work for the low-income worker, since they may retain 50% of the extra income from employment.

— The use of sales taxes

Options I and II would maintain the status quo with regard to sales taxation, while option III would considerably extend the sales tax base, leaving only food, prescription medicine and professional services exempt. Under the last two options, the government would be in a position to raise a further $900 million in revenue which would be applied to further reduce the marginal tax rates of all taxpayers.

Chapter VI
Effects of the Proposed Reform

Chapter VI attempts to illustrate the effects of the reform on:

- the tax situation of different types of households according to income level;
- the degree to which the stated objectives of the reform are achieved (equity, economic efficiency and income redistribution);
- the government's finances.

6.1. The effects of the reform on the tax situation of households

- ***Middle-income households:*** The group of households earning between $15 000 and $50 000 per year makes up 45% of taxpayers, and most of the households included consist of couples with children and only one spouse working. Under the reform, and depending on income and the option chosen, such a household with two children between 6 and 11 would benefit from a reduction in its tax burden ranging from $530 to $1 365. However, if the children are in the 2 to 5 age range, the improvement is not as great, because the $500 availability allowance would be eliminated.

  A substantial portion of the reform's benefits would be directed toward providing better coverage for the essential needs of dependent children of middle-income families. Thus, the reform is less advantageous for single persons and childless couples. The same holds true for couples with both spouses working, since their aggregate personal exemptions would no longer exceed those of a couple with only one spouse working. Finally, single persons who share their dwelling would derive less benefit from the reform because their essential needs will be deemed to be less than those of single persons living alone.

- ***Low-income households:*** The effect of the reform on this group of households depends on their reaction to the various possibilities that are offered to them. If a household participates in a reintegration activity, its disposable income will go up under option I relative to its current situation. Under options II and III however, its disposable income will not change from its current level. On the other hand, should it not be available for a reintegration activity, its disposable income will drop noticeably under options II and III, but remain unchanged under option I.

The reform also boosts the incentive to work by leaving in the hands of the worker a larger portion of the income he earns as a result of returning to the labour market. To illustrate, a couple with two children, and whose head is a beneficiary under the existing social aid system, receives a net hourly wage of only $0.84 if he accepts employment at the minimum wage. His net hourly wage would rise to $1.45 under option I, and rise to $2.06 under options II and III.

Under each of the options, the disposable income of young people 21 to 29 who have no children will be raised by participating in activities designed to prepare them for the labour market. However, the additional income for participating in such activities is highest under options II and III.

As we shall see in section 6.3, a substantial portion of the cost of the reform will go to increasing the income of low-income workers, or to raising the benefits of those, particularly young people 21 to 29 who have no children, who participate in such activities.

- ***High-income households:*** As a general rule, the reform proposes that the net contribution of this group of taxpayers be appreciably reduced to improve the competitiveness of the Québec tax system. However, the option selected has a significant impact on the size of the reduction.

The tax burden of a household with two children between 6 and 11 and only one spouse working in the labour market earning $75 000 would be reduced by about $1 500 under options I and II, and by about $2 200 under option III. By investing in a Stock Savings Plan however, the taxpayer can reduce his tax liability even more and, by the same token, the advantage in terms of tax burden enjoyed by his Ontario counterpart.

This taxpayer currently pays $2 604 more in income tax than he would in Ontario, if he makes a contribution to a Stock Savings Plan equal to the average contribution paid into this type of plan by all taxpayers in the same income bracket. The tax burden differential could be reduced to $1 194 under option I, to $1 293 under option II, and only $677 under option III if the taxpayer continues to pay the same amount into an SSP.

6.2. The impact of the reform on stated objectives

- ***Objectives related to equity:*** By reworking personal exemptions and various deductions, the essential needs of the taxpayer and his dependents would be more fully taken into consideration. The reform would make it possible to improve the equity of the system in regards to many taxpayers. This is particularly true of single persons living alone, of couples, according as to one or both spouses work outside the home, and of the allowance made in the tax system for the essential needs of children. Furthermore, reform options II and III would lessen the disparity in the treatment afforded to persons under 30 and persons 30 or over who receive benefits under the income guarantee program. Finally, the new tax and transfer system is more equitable in the manner in which it takes child care expenses and employment-related expenses into account.

- ***Objectives related to economic efficiency:*** With respect to this objective, the results presented in Chapter VI indicate that under each of the reform options, the economic well-being of the population, employment and domestic production would improve. Nevertheless, those options which provide the greatest incentive to work are the most likely to generate employment and, as a result, lead to the best economic performance. The number of jobs created under each of the options has been estimated as follows:

  Option I: between 18 000 and 30 000
  Option II: between 38 000 and 58 000
  Option III: between 48 000 and 73 000

  These figures illustrate the advantage of relying less heavily on taxes on production relative to consumption taxes, and of reducing marginal tax and transfer reduction rates.

- ***Objectives related to income redistribution:*** The results presented in Chapter VI indicate that when households are grouped by income decile (sub-groups containing 10% of households), regardless of the option under consideration and the assumption as to the reaction of households to the new tax environment, the disposable income of all income deciles would be higher after the reform than before.

  Under all the reform options the second decile posts the greatest improvement in its relative economic situation, followed by the third decile, then the fourth, and so on. The reform would increase income redistribution by allocating more benefits to the most disadvantaged than to those who are better off, even though the latter would also benefit from an improved tax situation after the reform.

6.3. The overall impact on the disposable income of households and on government finances

- ***The impact on the disposable income of households:*** The government requires a financial leeway of some $600 million to carry out the reform. This sum is increased by the federal participation in the costs of the new income guarantee program which range, depending upon the option, from $170 million to $275 million. All told, the reform will mean a reduction of between $770 million and $875 million in the net contribution of Québec households. The following table provides a breakdown of the reform's impact by income bracket.

The table shows that the greater part of the benefits flowing from the reform will accrue to low and middle-income households: households earning less than $15 000 will receive between one half and two thirds of the benefits of the reform, 51% under option III, 56% under option II, and 66% under option I. Indeed, each of the reform options allocates at least two thirds of its benefits to households earning less than $30 000, namely, 68% under option III, and approximately 80% under options I and II.

An analysis of the benefits of the reform by socieconomic groupings (see Table VI.20) reveals that couples with children will gain most from the reform, whatever their level of income. Under each of the three reform options, the disposable income of this group will grow by approximately $330 million. With 27% of households, this group will account for about 40% of the benefits flowing from the reform.

Other major winners under the reform are single persons earning under $15 000 per year, who account for 60% of low-income workers who will receive benefits under the new income guarantee program. With only 22% of households, this group will receive between 31% and 39% of the benefits flowing from the reform, depending upon the option chosen. Single-parent families currently receiving social aid will also gain under the reform by being eligible for the new child care expense subsidy if they participate in reintegration programs.

Table B
Breakdown of the impact of the reform by income group
(in percentage)

	Options		
Income group	**I**	**II**	**III**
• Under 15 000 $	65.8	56.0	50.8
• Between 15 000 $ and 30 000 $	14.5	23.1	17.6
• Between 30 000 $ and 50 000 $	10.5	12.3	15.4
• Over 50 000 $	9.3	8.7	16.2

- ***The impact on government finances:*** Whichever option is chosen, the reform will cost the government about $600 million when it is fully implemented. However, this estimate does not allow for the additional tax receipts (positive or negative) which each of the options may generate when the economy has fully adjusted to the new tax and transfer systems. Thus, by concentrating on the incentive to work, option III will encourage a recovery in employment which could produce tax receipts for the federal and Québec governments of between $730 and $880 million, depending upon the strength of individuals' reactions to the new tax environment. Under option II, net tax receipts for both levels of government would increase by between $340 and $580 million.

However, increased employment will result in greater tax receipts for the federal and Québec governments, as well as a reduction in federal transfers to Québec, so that the gouvernement du Québec will lose 50% of the effect of the reform on its net tax receipts to the federal government. In other words, when all these factors are taken into account, the federal government will benefit most from the reform's indirect effects, while Québec could recover between $250 and $350 million of its initial investment in the reform under option III, and between $100 and $200 million under option II.

Chapter VII
Basic Choices

The reform of the personal tax and transfer system has a direct effect on the financial situation of all Québec households while at the same time modifying the core of the government's social policy. The reform implies that Québec society must make some fundamental choices with respect to the well-being of the community and the future thrust of Québec's economic policies. Chapter VII seeks to highlight and refocus the reader's attention on the basic social choices which the reform entails. These basic choices bear on the following points:

a) The taxation unit and the transfer unit to be used.

b) Identification and assessment of essential needs.

c) How essential needs are to be covered.

d) The treatment afforded to different categories of households.

e) The integration of the tax and transfer systems.

f) The choice between tax exemptions and tax credits (or allowances).

g) The extent to which taxes on consumption are utilized.

h) The introduction of a minimum income tax, or limitation in the use of certain deductions.

Finally, Chapter VII concludes by specifying that the reform option preferred by the government is option II. In the short-term, option II appears to be the easiest to undertake since it is a compromise which allows the major objectives of the reform to be attained without a major overhaul of the tax system. However, this choice is subject to review should a significant social consensus in favour of either option I or option III emerge.

Glossary

Glossary

Ability to pay:
an indicator of a taxpayer's ability to contribute to the financing of government expenditures.

Additional tax burden: *see* **Tax burden differential.**

Assistance rate:
the ratio obtained by comparing the amount of government assistance paid to an individual with the level of his recognized needs and those of his dependents, including the costs incurred to earn income.

Average tax rate:
the value of taxes paid as a percentage of **private income**.

Basis of taxation:
an economic aggregate which serves as a reference for measuring a taxpayer's **ability to pay**, for example, personal income or consumption.

Consumption taxes:
the body of retail sales taxes, taxes on the sale of fuel, tobacco, restaurant meals and hotel accomodation, alcoholic beverages and telecommunications.

Dead loss: *see* **Economic loss**

Degree of progressivity:
the percentage difference in average income tax rates between the highest income bracket and the lowest; the higher the degree of **progressivity**, the more progressive the tax structure; the more negative the degree of **progressivity** of a tax, the more regressive its structure.

Disposable income:
personal income less income tax.

Economic loss:
the negative economic effect of high **implicit marginal tax rates**; it is reflected in reduced employment, lower production and consumption, and a smaller **tax base**.

Economic model:
a way of depicting reality which makes use of a symbolic representation of the relationships between two or more socioeconomic variables in order to predict economic phenomena.

Equalization:
a federal program of unconditional transfers designed to allow each province to provide a level of public services which is relatively comparable to that of other provinces without having to fall back on rates of income tax which are significantly higher than those in other provinces.

Equity: *see* **Horizontal equity.**

GDP: *see* **Gross domestic product.**

Gini ratio:
the most common synthetic indicator of inequality of income distribution. Its value can range from zero to one, and is based on centiles of income obtained by dividing households into 100 groups of equal size but in ascending order of income. A value of 0 indicates that income is equally distributed among households, while a value of 1 indicates that the distribution is completely unequal, being entirely concentrated in one centile.

Gross domestic product:
the value of all goods and services produced or provided by the factors of production located within the country, before any deduction for depreciation of the stock of capital. The GDP is frequently used as an indicator of a country's overall fiscal capacity.

Gross national product:
the value of total goods and services created or provided by the economic factors living within a country, during a given period, calculated before any deduction for depreciation of the stock of capital.

Horizontal equity:
with respect to a **tax system**, a principle which holds that the **tax rates** applied to **ability to pay** should be the same for all categories of taxpayers having the same ability to pay.

Implicit marginal tax rate:
for each additional $1 000 of income, the net impact of the reduction of **transfers** and the increase in taxes and contributions. It is the combination of the **marginal tax rate** and the **marginal transfer reduction rate** together with the increase, if any, in child care costs not covered by the government in relation to the increase in employment income.

Important but nonessential needs:
expenditures for public transportation, recreation and reading.

Income decile:
division of population units into ten equal portions in ascending order of income.

Income quintile:
division of population units into five equal portions in ascending order of income.

Income subject to tax:
sources of income included in the income **tax base**.

Income tax system:
the body of legislation dealing with income tax.

Indexation:
a procedure which is intended to protect the taxpayer during periods of inflation against a decrease in **purchasing power**, when it is applied to the **transfer system**, and, when applied to the **tax system**, protects against automatic increases in tax which do not stem from an increase in **ability to pay**.

Instalment:
a preliminary payment of tax or transfers until the year-end reconciliation for purposes of calculating the precise amount of tax to pay or of transfers to receive.

Integration:
the harmonization of **transfer programs** amongst themselves and with the **tax system**.

Investment income:
income received by the owners of capital and/or securities; can take the form of interest, dividends, etc.

Long-term essential needs:
expenditures not requiring regular payments, such as clothing and furniture.

Lump-sum tax:
an identical amount of tax which is collected equally from every citizen, regardless of his income, or of the goods and services he consumes.

Lump-sum tax reduction:
an amount which is deducted from the tax payable of every taxpayer, and does not vary with the taxpayer's income.

Marginal income tax rate:
for each **taxable income bracket**, the percentage of such income which must be paid in income taxes.

Marginal tax rate:
the part of an additional $1 000 of employment income which is paid over to the State. Included are net income taxes and contributions to the Québec Pension Plan and to unemployment insurance.

Marginal transfer reduction rate:
the reduction in transfer payments expressed as a percentage of the increase in employment income.

Net contribution:
total of net taxes, unemployment insurance and Québec Pension Plan contributions, sales and property taxes, less tax credits and **transfers**.

Net domestic product:
gross domestic product after deduction of the depreciation of the capital stock.

Net hourly wage:
personal income less income tax and contributions payable, any reduction in transfers, and the amount, if any, required to pay child care expenses not covered by government, all divided by the number of hours worked.

Net salary:
the salary paid to an employee after deductions such as contributions to unemployment insurance and the Québec Pension Plan, federal and provincial income tax, and other deductions.

Net income tax:
the total of federal and provincial personal income taxes, from which are subtracted **transfers related to income tax**. For individuals living in other provinces, health insurance premiums, if any, are added, such as OHIP premiums in Ontario.

Neutrality:
with respect to the **tax** and **transfer systems**, the principle according to which these systems should not influence the decisions of individuals, by offering financial incentives, as to which goods and services they consume, how active they are in the labour market, how the spouses decide to divide the time at work between themselves, marital status, the type of family makeup, or other forms of socioeconomic behaviour.

Numerical general equilibrium model of the Québec economy:
a model which has been developed to simulate the impact of the proposed reform on the **tax** and **transfer systems**, and which can also measure the **economic loss** attributable to existing federal and provincial tax and transfer systems.

Overall tax burden: *see* **Net contribution.**

Over-coverage:
the result of poor integration between two components of the **tax** and **transfer systems**, each component providing full or partial coverage of the same need for the same target population.

Person able to work:
a person who is capable of gainful employment (includes those who are temporarily unable to work).

Person unable to work:
a person who, for health reasons or because of age, is acknowledged to be permanently incapable of gainful employment.

Person who is available:
a person who is able to work and who is actively searching for employment or a **reintegration activity**.

Person who is not active:
person able to work who is not employed and does not participate in a **reintegration activity**.

Person who is not available:
person able to work who refuses to hold or search for a job or a **reintegration activity**.

Personal exemption:
in the **income tax system**, the deduction of that part of income needed to cover the taxpayer's essential needs and those of his dependents.

Personal income:
the sum of **private income** and government **transfers**.

Private income:
a household's total employment, rental, property and other income which does not include government **transfers**.

Progressivity:
refers to a **tax system** whose average rate increases as **personal income** increases. Personal income tax is said to be progressive because the proportion of income it represents increases as income increases.

Property tax:
a direct tax which redistributes income for the benefit of local collectivities, based on the assessed value of lands and buildings; it includes municipal and school board own-source income collected from residential property owners or tenants, on the assumption that the property taxes on rental buildings are entirely passed on to tenants in their rent.

Property tax credit:
as proposed under the reform, a refund to low-income earners of the portion of property taxes in excess of property taxes paid on essential housing needs which are already taken into account in the **personal exemptions** and ordinary benefits under the income guarantee program.

Property tax refund:
a refund of part of the municipal and school property taxes paid on the principal residence granted to low and middle-income tenants and property owners.

Purchasing power:
the ability to acquire a quantity of goods and services available on the market in return for a sum of money.

Real income:
income, adjusted for inflation, measured in relation to an arbitrarily chosen base year. Also called constant dollar income.

Redistribution of income:
term used to refer to the totality of measures designed to reduce the disposable income of those at the high end of the income scale in order to share with those at the lower end of the scale.

Regressivity:
term applied to a tax whose average rate decreases as **personal income** increases. Sales taxes and **property taxes** are considered to be regressive since the proportion of income they represent declines as income increases.

Reintegration activity:
a government program designed to help persons who are able to work return to the labour market.

Sales subject to tax:
the kinds of goods and services included in the sales **tax base**.

Sales tax credit
as proposed under the reform, a refund of sales tax paid by low-income earners on goods purchased to cover their essential needs.

Short-term essential needs:
current expenditures requiring at least one monthly payment, such as food, housing, communications and expenditures for household services and personal services.

Sixteen and one-half percent federal income tax abatement:
a 16.5% reduction of the basic federal income tax granted to Québec taxpayers in order that the gouvernement du Québec might increase its own income tax without increasing the **overall tax burden** of its taxpayers.

Subterranean economy:
the totality of undeclared activities which escape taxation.

Tax abatement: *see* **Sixteen and one-half percent federal income tax abatement.**

Tax base:
the value of the object subject to particular tax. For example, the income tax base consists of the value of **income subject to tax**, while the sales tax base consists of the value of **sales subject to tax**.

Tax burden:
a general term which designates an individual's contribution to the finaning of government expenditures via one particular tax or all taxes taken together.

Tax burden differential:
the difference between a Québec taxpayer's existing **tax burden** and what his tax burden would be under a different **tax system**, Ontario's, for example.

Tax effort: *see* **Tax burden.**

Tax evasion:
concealing **income** and **sales** which are **subject to tax**.

Tax rate:
for each **taxable income bracket**, the percentage of such income which must be paid in income tax.

Tax receipts:
gross revenue derived from tax collections.

Tax system:
the body of legislation dealing with the levying of all forms of taxes.

Taxable income:
for a given taxation year, the income calculated in accordance with the requirements of the **income tax system**, to which is applied the scale of **marginal income tax rates** to obtain income tax payable.

Taxable income bracket:
interval of taxable income to which **marginal income tax rates apply.**

Taxation field:
classification of tax receipts according to principal sources of taxation, such as **personal income**, corporate profits, consumer spending, succession, property values, etc.

Taxation unit: *see* **Taxpaying unit.**

Taxpaying unit:
individual or group of individuals who form the reference base for the collection of taxes.

Total income: *see* **Personal income.**

Transfer:
income distribution mechanism which takes the form of a payment made in this case by the State, without any direct and apparent exchange, for a social and economic purpose.

Transfer programs: *see* **Transfer system.**

Transfer system:
a system which encompasses all transfer and assistance programs, from social aid to free education and pension plans. Québec's system of transfers to individuals consists of a multitude of transfer programs whose three major functions are to guarantee a basic minimum income, provide support for employment income, and to assist entry into the labour market. The system includes universal programs, programs based on need, and insurance programs.

Transfer unit:
individual or group of individuals who form the reference base for the payment of a transfer.

Transfers related to income tax:
transfer payments which reduce or eliminate income tax payable, such as federal and provincial family allowance payments, the availability allowance, and the federal child tax credit.

Underground economy: *see* **Subterranean economy.**

Value added tax:
a **consumption tax** levied at each stage of the production-distribution process; the final burden of the value-added tax (VAT) is paid by the consumer.

Vertical equity:
with respect to a **tax system**, a principle which holds that a person with a greater **ability to pay** should pay a greater proportion of his income in taxes.

Zero tax threshold:
the level of income at which the taxpayer begins to pay income tax.

Zero transfer cutoff point:
the level of income at which the taxpayer ceases to receive **transfers.**

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